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DEFENSE PROCUREMENT FRAUD LAW ENFORCEMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON
ADMINISTRATIVE PRACTICE AND PROCEDURE

OF THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

NINETY-NINTH CONGRESS

FIRST SESSION

ON

HOW TO DETER FUTURE FRAUD AND CORRUPTION IN NATIONAL DEFENSE PROCUREMENT

OCTOBER 1, 1985

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DEFENSE PROCUREMENT FRAUD LAW ENFORCEMENT

TUESDAY, OCTOBER 1, 1985

U.S. SENATE,
SUBCOMMITTEE ON ADMINISTRATIVE
PRACTICE AND PROCEDURE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:03 a.m., in room SD-226, Dirksen Senate Office Building, the Hon. Charles E. Grassley, chairman of the subcommittee, presiding.

Also present: Senators Specter and Metzenbaum.

Staff present: Lisa Hovelson and Steven Ross.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. I would like to call this hearing of the Subcommittee on Administrative Practice and Procedure, a subcommittee of the Senate Judiciary Committee, to order. I would like to say, in my opening statement, on August 26, 1982, Attorney General William French Smith and Secretary of Defense Caspar Weinberger announced the establishment of the new Defense Procurement Fraud Unit.

That announcement was made with much fanfare and with a great deal of hoopla. That unit was to concentrate national efforts on fraud and corruption in the complex area of defense procurement. Now, great promises were made of a tough crackdown on defense fraud.

I would like to quote to you from the Justice Department's own words of that announcement:

> The Unit was specifically designed to overcome numerous problems that had been encountered in the investigations of . . . important cases—such as Litton and General Dynamics in the 1970's and the early 1980's. The Unit's goal is to deter future fraud by conducting nationally significant procurement fraud and corruption investigations and prosecutions.

The Defense Department's inspector general was to be the investigative arm of the team, and the Justice Department the aggressive prosecutors. Together, these tigers were supposed to stomp out fraud among defense contractors.

It is 3 years later which is more than ample time for a record to be established, and for judgment to be passed on that record.

Frankly, the Fraud Unit's record is, to put it very kindly, inadequate. It certainly does not match the rhetoric, and especially not the hoopla of 3 years ago.

While some of our witnesses will defend the unit today, both the Department of Justice and the Department of Defense have frankly admitted that the Government's overall efforts against fraud in the defense industry is not up to snuff. The Department of Justice admitted this in an internal report to the Attorney General last April and DOD's inspector general complained repeatedly about the lack of prosecutions in his testimony before Congress that same month.

The principal cause of the Fraud Unit's failure is the unwillingness of those involved to recognize how bad and how pervasive the fraud problem really is. If the magnitude of their efforts is a measure of how they view the magnitude of the problem, then the Fraud Unit must not believe there is a significant problem at all.

Those of us outside, who have watched the unit's performance these 3 years, are having a hard time not concluding the effort has been little more than "Show Biz".

Certainly, after 3 years, one can legitimately claim there has been more rhetoric than results. Like Diogenes who, all his life, searched for an honest man, we are still searching for anyone who really believes the Fraud Unit has done a thorough job of combating defense fraud.

The Defense Department and the Justice Department both tell us that fraud is their No. 1 priority. Yet the record speaks volumes to the contrary.

Their statistics are inflated, and really have been from the very beginning. The top 100 contractors are getting off virtually untouched.

The Fraud Unit's misery index is just that—miserable. Prosecutions are scarce and, most important, recovery is scant.

In 1984, the unit prosecuted only 8 cases. I would like to repeat that. In 1984, the Fraud Unit prosecuted only 8 cases. I am referring to the same Fraud Unit that was established, with all that fanfare, on August 26, 1982.

One of those eight was actually prosecuted by the main Department of Justice Fraud section.

Another of the eight was a nondelivery case, where the guilty party only had to pay the $78,000 he kept for a product that he did not deliver.

Another of the eight was the Sperry case, which actually was not worked on in 1984. All work had been done in the Sperry case in 1983, but the Fraud Unit had to wait for the judge to finally accept what he termed an unconscionable settlement, because of its low-level fines and failure to hold individuals responsible.

The final 5 cases all stem from the Defense Industrial Supply Center in Philadelphia * * * relatively simple bribery cases the local U.S. Attorney offices could have and would have handled without the Fraud Unit.

So if we strip away all the hype and all the rhetoric, and just look at the record, what do we have left?

The answer is a very poor performance by the Nation's No. 1 crime-fighting outfit.

We have invited the Departments of Justice and Defense to explain themselves today. This hearing has been called to review the record, and to get some answers.

[Prepared statement of Senator Thurmond follows:]

PREPARED STATEMENT OF SENATOR STROM THURMOND

In these days of the huge Government spending and budget deficits, the Federal Government must do all it can to avoid wasteful or unnecessary spending and ensure that it gets every nickel out of its procurement dollar.

Unfortunately, despite heightened public awareness and continued efforts by the administration, wasteful spending persists and greedy or dishonest contractors continue to bilk the Government for millions of dollars. Millions of dollars, that are desperately needed to finance other vital social and defense programs, are being frittered away. The end result, of course, is a higher cost of Government and a weakened economy.

As many of you are aware, on September 16, the administration announced an eight point package of anti-fraud legislation. The administration believes this legislative initiative to be the most important that Congress could enact to reform the procurement process and reinforce its efforts to prevent waste, fraud and abuse in Federal programs. As I stated when I introduced the anti-fraud package on behalf of the administration, it is time that those who defraud the Government are put on notice that these fraudulent and illegal practices will be met with swift and aggressive prosecution.

Today, this subcommittee resumes its consideration of the Department of Justice efforts to control procurement fraud. While the distinguished chairman of the subcommittee is to be commended for his leadership in this area, it is my hope we can work closely with the Department of Justice and the Department of Defense in developing the most effective response possible to the procurement fraud problem. This hearing should provide the Senate with helpful insight into the practical problems encountered in prosecuting procurement fraud cases.

I would like to join with the subcommittee in welcoming our witnesses, and say to my friend, the able chairman, that I look forward to working with him in this important area.

Senator GRASSLEY. Senator Metzenbaum.

OPENING STATEMENT OF HOWARD M. METZENBAUM, A U.S. SENATOR FROM THE STATE OF OHIO

Senator METZENBAUM. First, Mr. Chairman, I want to commend you for your leadership in this effort to deal with the whole issue of white-collar crime, particularly in this instance, having to do with the failure of the Department of Justice to do that which so many of us think they should do, and that is to treat white-collar criminals in the same manner that they treat blue-collar criminals.

It is an accepted fact that white-collar criminals in this country can get away with almost anything, and they do not windup going to jail; they windup with the corporation paying a fine.

Fraud in this context is just another species of white-collar crime. Examining some of the materials in the public record prior to this hearing, it is clear that this Justice Department is sadly deficient.

We have seen reports of the Department of Defense coming up with 400 cases and presenting them to the Department of Justice, and 11 of them winding up in prosecution.

But almost in no instances do you have the individuals prosecuted. What does anybody really care about having the corporation prosecuted and the corporation pays the fine? What difference does it make if they pay a fine? It is the stockholders' money.

The people who are guilty of committing the crime, the ones who plan it, the ones who are participants in the scheming, to make it

occur, they walk away and they laugh about it, and they go to their country club and say what a joke it was, we paid *x* dollars in a fine. It is not even a drop in the bucket, the fines. Nobody goes to jail. Over 70 percent of the military procurement in this country is handled by the top 100 defense contractors. And, of these, only three have been prosecuted.

I heard the chairman speak about the Sperry case. That is an all-too-familiar story. The Government is bilked out of hundreds of thousands of dollars, and the criminal penalty is a $30,000 fine. That's hardly the bill for them at the Stork Club over a period of a couple of months. What is $30,000 to a major corporation in this country?

To paraphrase a slogan concerning another issue: Corporations don't commit crimes, people do.

Sperry pled guilty to the charge that it did make and present false statements to the Department of Defense. But Sperry did not do that; there were some individuals at Sperry who did it.

Nothing happened to them. Nothing happens to any white-collar criminals in this country. They hold up as a great big symbol the fact that they had two criminal prosecutions of white-collar criminals in this country. One, I think his name was Mr. Thayer—is that right? Mr. Thayer. And the other was that activist democratic politician down in Tennessee, Jake Butcher. Big deal.

But what about the General Dynamics officials and all the other officials of so many other companies in this country?

Jail is not a deterrent. For the thief on the street or the one who slugs an individual or even uses a gun, many of those instances have to do with when the individuals are doped up, coked up; they go to the slammer. When they come out, they do the same thing over again.

If incarceration is truly to be recognized as the deterrent, which it can and should be, it has more application to white-collar criminals than to any other kind of criminal.

The recidivism that occurs, of criminals coming back over and over again, relates to those who are involved in street crimes, in violence. They are the ones who keep coming back over and over again. The white-collar criminal, he is concerned about his standing with his peers.

The mugger on the street is not really concerned about his standing with his peers.

The white-collar criminal commits his acts out of sheer greed, and the way to deter them, and the way to make certain it does not happen again, is to send them to jail, send them to prison.

But vigorous prosecution of white-collar criminals is not the order of the day in this administration. Whether it has to do with pharmaceutical companies or defense contractors, nobody winds up going to jail. Plea bargaining is the accepted mode.

If we are really going to have deterrents, then we are going to have to see to it that the Department of Justice does that which it is supposed to be doing.

This is an administration that claims it is a law and order administration. Law and order means meting out justice equally to all people, regardless of the color of their collar. And, yes, maybe even regardless of the color of their skin as well.

So I would say to you, Mr. Chairman, that I think it is high time that the Department of Justice does that which we expect of them,

that they no longer permit corporations to get off with fines and some modest restitution, but that they start prosecuting some of those who are really the major criminals of this country, those who commit crimes in permitting pharmaceuticals to come to market that cause loss of life, that harm children, and defense contractors who willfully and intentionally defraud our Government.

Senator GRASSLEY. Thank you, Senator Metzenbaum. I appreciate your opening statement and your efforts toward making the work of this subcommittee successful.

Our first witness today is Mr. Joseph Sherick. Mr. Sherick is the inspector general for the Department of Defense, and he, of course, is responsible for that Department's main criminal investigative service.

I want to thank you for coming today.

Before you start, Mr. Sherick, I would like to clear up some procedural details. We will be asking each witness to summarize their prepared remarks. Full written statements in every instance will be inserted in the record.

We are going to operate the timing lights. They will come on in 7 minutes.

We would like to have you limit your statement to that amount of time.

And also, as we are accustomed to doing in our oversight hearings, I will be putting each witness under oath, so I would like to have you stand, Mr. Sherick.

Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. SHERICK. So help me, God.

Senator GRASSLEY. Would you please proceed?

TESTIMONY OF JOSEPH SHERICK, INSPECTOR GENERAL, DEPARTMENT OF DEFENSE

Mr. SHERICK. I am pleased to appear before the subcommittee today to discuss the Office of the Inspector General, Department of Defense, and the investigation of procurement fraud cases in the Department.

As general background, let me begin by describing the history and organizational structure of my office, as well as some general data on the Department of Defense and its operations.

The Defense inspector general was established in September 1982 as a provision of the fiscal year 1983 Defense Authorization Act.

The DOD IG was established to provide and coordinate audit, investigative, and inspection support to the Department's activities located throughout the world, and to monitor and evaluate the Department's programs and operations. The DOD, as an operating agency dedicated to the military defense of the Nation, spends about $600 million every day.

To carry out our mission, we have 5,500 installations or activities located in the United States and 21 countries around the world. We employ about 6.3 million people directly or indirectly. We have over 4 million items cataloged in inventory. And we place approximately 15 million contracts a year, worth about $150 billion, and we deal with about 60,000 prime contractors.

In fiscal year 1984, 23 companies did more than $1 billion worth of business as prime contractors with DOD, and over 100 did $100 million or more.

To assure that these vast resources are protected and managed wisely, the Department employs 19,400 auditors, investigators, and inspectors. About 900 of these people work directly for the Defense inspector general. The remaining auditors, investigators, and inspectors are under the direct operational control of the military departments and the Comptroller of the Department of Defense for the Defense Contract Audit Agency [DCAA], but they fall under the policy and oversight responsibilities of the Defense inspector general.

The inspector general is assisted by six assistant inspectors general [AIG]. These include an IG for auditing, an IG for audit follow-up, an IG for audit policy and oversight, one for criminal investigations policy and oversight, one for investigations, and one for inspections.

The inspector general's responsibility regarding DOD criminal investigations is threefold: He conducts criminal investigations directly through his assistant inspector general for investigations, who heads the Defense Criminal Investigative Service. He also provides criminal investigative policy to all DOD criminal investigative organizations. And, finally, he oversees all criminal investigations, including those conducted by the Army, Navy, and Air Force.

When the IG was established, Congress decided to leave the military criminal investigative organizations—the Army Criminal Investigation Command, the Naval Investigative Service, and the Air Force Office of Special Investigations—in their own respective military departments. Currently in DOD there are 6,406 people assigned to the DOD criminal investigative organizations, of which 3,787 are criminal investigators. Of the 3,787 criminal investigators, 232 are assigned directly to the IG.

It is important here, however, that I point out that, in addition to fraud, the military investigative organizations, and my own criminal investigators, are responsible for investigating a broad range of other serious crimes. In the military departments, their priorities include narcotics violations, thefts, arson, vandalism, murders, rapes, assault, and other crimes of violence, which occur on military bases.

Furthermore, both the Navy and Air Force criminal investigative agencies have significant responsibilities regarding foreign counterintelligence.

I estimate there are about 777 fraud designated criminal investigators in DOD at present. We have recommended adding 400 more over the next 3 years. These figures compare to only 425 fraud designated criminal investigators in 1982. Although we do not have records for 1980, the number was probably less than 100.

I believe my relationship with the military criminal investigative organizations is a productive one. My office, through its oversight and policy role, provides advice and the guidance in investigative techniques and assists these organizations with training and implementation of new investigative techniques. We also provide leadership and coordination for DOD-wide efforts; my office serves as the primary DOD contact between the Defense criminal investigative

organizations and the Department of Justice, including the Defense Procurement Fraud Unit and the 94 U.S. attorneys across the country.

As IG, I have placed great importance on enhancing the ability of DOD investigators to deal with allegations of fraud. We have conducted 18 5-day contract fraud training seminars which have provided advanced contract fraud training to over 600 criminal investigators.

I also believe that it is essential for procurement personnel and auditors to be sensitive to fraud schemes by Government contractors. Historically, the majority of contract fraud cases are discovered by these officials. Therefore, these officials must be aware of contract fraud indicators.

In this regard, we have prepared a handbook on contract fraud indicators, which has been distributed to over 50,000 DOD procurement, audit, and investigative personnel. We have also conducted over 400 training sessions for some 20,000 procurement personnel. This is in addition to the 6,400 fraud training sessions which are provided to 240,000 DOD management officials by criminal investigators assigned to the Department.

In addition to these continuing efforts regarding training and awareness, my office recently completed a review of suspension and debarment authorities within DOD. Under the Federal acquisition regulation, the DOD has the right to protect itself from contractors who cannot adequately demonstrate their responsibility as Government contractors. The regulations relating to suspension and debarment are designed to enable the Government to protect itself from such contractors by barring them from doing business with the Federal Government.

I personally was unhappy with the use of suspension and debarment in the Department, and we did a review of that problem. As a result, we prepared a report which outlines the weaknesses in the Department's use, and how the Department could increase the effectability of suspension and debarment.

In 1984, DOD suspended and debarred over 450 contractors com pared with 79 in 1980.

Senator GRASSLEY. Can you finish in about 1 minute?

Mr. SHERICK. Yes.

The inspector general subpoena is another tool that I have used extensively in the Department. I find it a very effective tool; it helps us avoid some of the severe limitations and other problems that we have with rule (6)(e), when we used grand jury subpoenas.

With respect to the investigation of criminal offenses, particularly procurement fraud, my office, over the past few years, has developed two key documents which identify investigative jurisdiction. One of these is a memorandum of understanding [MOU] with the Department of Justice, which upgraded a 1955 MOU that was completely out of date. The second document allocated to the military departments and among the military departments jurisdiction and responsibility for criminal investigations.

During the period 1982 to 1984, we have seen an increase in the number of fraud investigations conducted. In 1982, 1,800 fraud investigations were completed, as compared to 2,311 in 1984.

From 1982 through 1984, the number of Department of Justice convictions in all types of cases resulting from our investigations has also increased. In 1982, there were 102 Department of Justice convictions, while in 1984 there were 181. In the first half of 1985 we have reported 156 Department of Justice convictions.

In relationship with the Department of Justice, I have to add that I feel that our relationships with the Department of Justice when I became the assistant to the Secretary of Defense, the predecessor to the inspector general, were practically nil.

In 1980, for instance, prior to my assuming the role as Assistant to the Secretary of Defense for Review and Oversight, the Army had referred over 300 cases to the Department of Justice. They got 300 declinations of prosecution. There was no day-to-day conversation with the Department of Justice, and I feel that one of the major things that we have done is to open an effective day-to-day dialog, establish an organization dedicated to solving our problems, establish a working relationship of mutual respect with the U.S. attorneys and, in effect, started us working together as a team.

I think that the Defense Procurement Fraud Unit has been a positive step in that direction. That is not to say I am completely happy with what has happened with the unit, but I feel that it was something that was seriously needed and, as you said in August 1983, for which we all had great expectations.

It did two things for us. One, it gave us a place to go, where we could promptly, hopefully get answers to the prosecutability and value of our cases.

The second thing that it did was to serve as a catalyst to energize the U.S. attorneys around the country, because we recognized early on that four lawyers in the Procurement Fraud Unit was not going to be much of a help to us in prosecuting our many cases. We needed those 94 U.S. attorneys.

It also served to give to the Department of Justice and the U.S. attorneys and the FBI the priorities the Department of Defense felt on its criminal investigations. Foremost among these priorities is product substitution. They are the most important cases that we want prosecuted. They are the cases where people are giving us inferior material and they are jeopardizing our ability to do our mission and, in many cases, the lives of our fighting men.

The second priority is cost mischarging/defective pricing. The third is corruption and kickbacks; and the fourth is theft.

Mr. Chairman, I do not have time to finish my statement, but I might say, in conclusion, I cannot say I am completely satisfied with the collective efforts of DOD or the Department of Justice in the procurement fraud area. Yet, given the almost nonexistent commitment of the two Departments in this area only 2 or 3 years ago, our progress since then has been clear, very positive, and productive.

I firmly believe more improvements and more resources are required. Specifically, I believe the following initiatives must be undertaken or continued if further progress is to be assured:

More audits by the Defense Contract Audit Agency in the incurred cost area, where the fraud is most likely. The Defense Contract Audit Agency is moving in this direction, and, hopefully, they will move almost completely in this direction.

Improved fraud training for auditors. One of the things we found early on was that our auditors and procurement people did not recognize fraud when they fell ove. it. We have to improve and extend that training.

Advanced fraud training for investigators. Here again the Department of Defense has many complex cases. We have many complex accounting systems and procurement procedures that many of these investigators are not used to dealing with, and we have to do everything we can to make them understand how we operate and how contractors operate. I think we are doing that.

Increased number of fraud investigators, consistent with my recommendations issued earlier this year. As I said, we now have about 800. I think the Department of Defense needs another 400 over the next 4 years. Here again, we are limited by training. We need the complete cooperation of the service Secretaries.

More specialized Defense procurement fraud training for the Department of Justice prosecutors involved in DOD fraud cases. I think again we have to emphasize the complexity of our process and what they have to do to understand what fraud is and what some of the schemes are that the contractors are pulling on us.

And significantly more Department of Justice prosecutors assigned to either the unit, the fraud divisions, the U.S. attorneys, or even possibly expanded use of military attorneys' offices to help in this process.

With these initiatives and the current resolve of the two departments, I have no doubt that we can realistically seek our objective of creating tremendous disincentives to fraud. And I agree with you that this is what we have to do. Only if these disincentives can be achieved through increased levels of criminal, civil, and administrative penalties can there be any legitimate expectation that fraud can be prevented.

I look forward to working with the Department of Justice and the Congress in these prevention efforts.

This concludes my remarks, and I would be happy to answer any questions by members of the subcommittee.

Senator GRASSLEY. Thank you, Mr. Sherick.

Have you read or are you familiar with the report of the Economic Crime Council to the Attorney General, dated April 30, 1985? This is a report by the Economic——

Mr. SHERICK. Yes; I read it with great passion.

Senator GRASSLEY. OK. The Council, which is headed by the Associate Attorney General, and composed of attorneys in the Criminal Division, U.S. attorneys and also FBI officials, they portray your performance as one leaving much to be desired. The report is particularly critical of your defense criminal investigative service and of the alarmingly low number and quality of referrals made by the Procurement Fraud Unit and the U.S. attorney's offices.

In essence, the report blames your office for the current state of inadequate law enforcement in the defense industry.

Before we go further, it is necessary to make sure that we know what we are talking about when we say referrals. So I would like to quote from a manual published by the Justice Department:

A formal referral occurs when the documents developed or obtained during an investigation are presented by mail or in person to the Department of Justice attor-

ney for a preliminary prosecutive opinion. In cases where an attorney must be consulted immediately upon receipt of allegations, a formal referral may be made without the presentation of investigative documents.

Let me ask you at this point, Mr. Sherick, why, as this report says, are your investigators and the DOD auditors not doing their job?

Mr. SHERICK. I do not agree with that report. We have a memorandum of understanding with the Department of Justice on basically what we are supposed to do, and I think we met that standard. I think we met it with a large number of referrals.

I recognize that there is a problem in semantics here on what a referral is, and I think, basically, that was the problem when the report was written. Somebody was using the Department of Justice definition, and we in the Department of Defense were not operating under that definition. That is what the Defense Procurement Fraud Unit was created for. It was created for us to get to a prosecutor early, give him an early allegation so that we could get from him his advice on the prosecutable merit of the case, his advice on who might take the case, whether the unit itself would be interested, or whether we should shop to the U.S. attorney, and, third, whether and what kind of an additional investigation that they felt would be necessary in order to make the case.

Senator GRASSLEY. Then the report is just plain wrong?

Mr. SHERICK. I think so; yes.

Senator GRASSLEY. Exactly how many referrals have you then made to the fraud unit since it began, and how many have they successfully prosecuted?

Mr. SHERICK. I think we have made about 200 referrals under the criteria of the——

Senator GRASSLEY. That is 200 since it was set up?

Mr. SHERICK. Right. Under the criteria of the memorandum of understanding.

Senator GRASSLEY. And how many of those were prosecuted?

Mr. SHERICK. I would say, by the unit itself, probably 10 or 20.

Senator GRASSLEY. Ten to twenty?

Mr. SHERICK. That is right. And some of those were jointly prosecuted with the U.S. attorney in Philadelphia.

Many more of them have been prosecuted by the U.S. attorneys. And I might say that, for instance, in the first half of calendar year 1985 we have had over 91 indictments; 51 of them were by U.S. attorneys and 4 of them were by the Defense Procurement Fraud Unit.

Senator GRASSLEY. Let me just add that on May 28 of this year I wrote to the Secretary of Defense, Mr. Weinberger, asking for an explanation of the claims in this Department of Justice report. To this date, I have received no response from Mr. Weinberger, and so, Mr. Sherick, I would ask if you were directed to respond to my inquiry, and, if so, do you know why it has never been answered?

Mr. SHERICK. No; I do not know. I thought it had been responded to.

Senator GRASSLEY. It is my understanding that it has not, and if it has, then——

Mr. SHERICK. Well, let me make a copy available to you.

Senator GRASSLEY. I would like to have a copy. Obviously, we have not received a response.

[The aforementioned material follows:]

United States Senate

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May 28, 1985

The Honorable Caspar W. Weinberger
Secretary of Defense
The Pentagon
Washington, D.C. 20301

Dear Mr. Secretary:

The Senate Judiciary Subcommittee on Administrative Practice and Procedure has been conducting an inquiry into the efforts of the Departments of Justice and Defense to combat fraud in DOD procurements. While our inquiry is far from complete, it is clear the agencies' enforcement of laws against fraud in the defense industry has been less than adequate.

Our attention so far has been focused more on the prosecutive end of defense fraud than the detection and investigative stage. Until now, it had appeared the failures of the enforcement system could largely be attributed to lack of activity on the part of DOJ prosecutors. However, the Economic Crime Council of the Justice Department reported last month that inadequate enforcement comes as a result of an "alarmingly low" number of referrals from DOD.

Specifically, the Council found that:

> "The Defense Criminal Investigative Service (DCIS), DOD's primary investigative arm, made less than ten referrals to the DPFU (Defense Procurement Fraud Unit) in the past nine months, and we also believe there were few referrals to U.S. Attorneys' Offices."

The Council's findings directly conflict with information provided us by DOD Inspector General Joseph Sherick regarding his office's referrals to DOJ and also Mr. Sherick's recent congressional testimony. Specifically, Mr. Sherick testified several hundred contract fraud investigations are underway and he continues to "pound them" over to the Procurement Fraud Unit. Additionally, in a March 22, 1985 letter to me, Mr. Sherick claimed 263 cases had been referred to the Fraud Unit.

If the Council's finding of "alarmingly low" referrals is correct, the Department of Defense and Mr. Sherick have grossly mislead Congress as to their enforcement activities. In that light, please inform me what steps you will take to correct the deplorable state of affairs in the Defense Criminal Investigative Service. If the Council's conclusions are not accurate, please supply clear and complete documentation and an explanation of the conflicting information.

Thank you in advance for your prompt attention to this matter.

Sincerely,

Charles E. Grassley
Chairman
Administrative Practice & Procedure
Subcommittee

Enclosure

THE SECRETARY OF DEFENSE
WASHINGTON, THE DISTRICT OF COLUMBIA

26 JUL 1985

Honorable Charles E. Grassley
Chairman
Administrative Practice and
Procedure Subcommittee
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

Thank you for your letter of May 28, 1985, regarding the recent Economic Crime Council Report and efforts of the Departments of Justice and Defense to combat fraud.

We have reviewed our copy of the Assistant Attorney General's June 6 letter to you in which he stated he was dismayed to learn that a draft of an internal document had been inadvertently released from the Justice Department and had created a misleading impression with respect to the effort of the Department of Defense concerning defense procurement fraud. He said we had done an "excellent job fighting defense procurement fraud." He went on to say,

> "Under his leadership, the Department of Defense has made important improvements, all of which are producing excellent cases of possible fraud for investigation and prosecution. He has also been instrumental in pursuing other reforms in the procurement process that are designed to protect the taxpayer's pocketbook. Mr. Sherick has shown himself to be a leader and a person who is always part of the solution-seeking process. He was personally responsible for securing an excellent memorandum of understanding between the Department of Defense and the Federal Bureau of Investigation that is designed to insure the best coordinated criminal investigations of defense procurement fraud of which this Government is capable. Mr. Sherick and I meet periodically to make sure that this aggressive effort is moving in the right direction."

Significantly, Mr. Trott's letter stated the draft report contained language that did not convey accurately the sense of the Economic Crime Council and that was specifically rejected in the final version.

I believe that Mr. Trott's letter and our relationship with the Department of Justice speak strongly for our cooperative work in combatting fraud. From a point of limited contacts in this area as recently as two and one-half years ago, we now

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have established what I believe to be the ingredients of an effective long-term effort. I am glad that Mr. Trott's June 6 letter to you states the real position of the Department of Justice and refutes the points made in your letter.

Common understanding between our Department and the Department of Justice have been reached on which investigations are sent to the Defense Procurement Fraud Unit for screening, evaluation, and action by either the Unit or the various United States attorneys.

There have been different definitions of the term "referral." It would appear that the Department of Justice use of that term in their draft report, since rejected by Justice, is restricted to investigations that have matured to the point where positive prosecution decisions can be rendered and the cases submitted to grand jury. In addition to such referrals, a large number of allegations and ongoing investigations have been referred to the Unit for early assessment of prosecutive merit and for other screening purposes. Even though many of these matters may not be accepted for criminal prosecution, this substantially larger number of cases reflects more completely the type and degree of dialogue that exists between the Department of Defense investigators and Department of Justice prosecutors. Since inception of the Defense Procurement Fraud Unit, a total of 263 investigations have been brought to the attention of the Unit by the Inspector General investigators. A listing and summary of these cases has been provided to your Subcommittee.

To focus just on the Defense Criminal Investigative Service "prosecutive referrals" to a single prosecutive unit over a nine month period of time does not, in my opinion, provide a complete picture of the type of supportive and cooperative relationship established between the Department of Justice and Department of Defense. Since inception, the Defense Criminal Investigative Service, which is the investigative arm of the Inspector General, has investigated matters leading to 267 indictments and 187 convictions. Some of these results have been obtained as a result of the direct involvement of the Defense Procurement Fraud Unit, which is located in the Washington, D.C. area. Many more were accomplished through the efforts of the United States attorneys located throughout the country.

As you may be aware, I have personally supported several enhanced antifraud initiatives in the past four years, including the creation of the Office of the Inspector General. Since 1982, we have increased the number of investigators in the Defense Criminal Investigative Service from less than 100 to 250. During the past two years, I have also entered into a new Memorandum of Understanding with the Department of Justice that stresses our role in the investigation of fraud, and I have joined with the Attorney General in the creation of the Defense

Procurement Fraud Unit. During the same period, the three military investigative organizations have been directed to establish the recognition of procurement fraud as a top priority.

In the past few years, we have provided fraud briefings to over 250,000 Defense employees, with particular priority given to educating those involved in procurement. In addition, I have recently directed that all quality assurance personnel within the Department of Defense receive specialized fraud training designed to focus on our largest potential problem--substitution of inferior products by irresponsible contractors. While the overwhelming majority of our contractors provide products of high quality, we cannot tolerate the efforts of some to provide us with defective material. Therefore, I have asked the Attorney General to make prosecution of this type of procurement fraud his top Defense priority, and he has agreed.

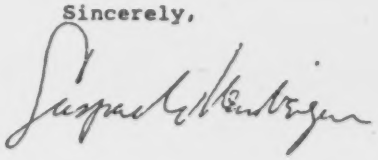
Our current inventory of procurement fraud investigations contains a substantially greater number of significant matters than only a few years ago. I believe this is in part due to a greater sensitivity within the Department of Defense and a more effective Department of Defense audit and investigative capability.

I am certain further progress can be made in pursuing significant allegations of fraud and am equally confident that Mr. Sherick is aggressively pursuing those avenues necessary to continue our momentum in this area. His current efforts include an initiative to provide increased numbers of fraud investigators not only for the Defense Criminal Investigative Service, but also for the military investigative organizations. He also has undertaken key initiatives in training fraud agents (in concert with the Department of Justice) and in stressing proactive efforts to identify fraud in our most vulnerable programs.

One of our top priorities is our desire to enhance further the mutual efforts of the Departments of Defense and Justice to combat procurement fraud. Mr. Sherick will maintain dialogue with senior officials in the Department of Justice to ensure their continuation of our joint efforts.

While we welcome any suggestions you may have for improving our ability to identify and eliminate procurement fraud, I think it is apparent that the worries expressed in your May 28 letter were based on inaccurate information.

Sincerely,



Senator GRASSLEY. I understand that you have spent the last few months visiting with the DCIS field offices. Have you heard from these field agents any complaints or criticism of the Fraud Unit?

Mr. SHERICK. I visited with not only the DCIS field units, I visited with the Naval Investigative Service, CID, OSI, all my field units; and if I have to go through my mind to find out if there were complaints, I would have to say yes, there were complaints.

One of the complaints that I found had to do with the travel requirement of the attorneys. The field investigators, of course, prefer to work with the U.S. attorney who happens to be right in town. Because they can get down to the court house, they can see them whenever they have to. He usually has the grand jury empaneled, and they can usually get their support in terms of subpenas, search warrants, et cetera, very readily.

On the other hand, I have heard a lot of compliments about the work that the attorneys from the unit are doing. So, on balance, I do not think that it is a complaint session about the Procurement Fraud Unit.

Senator GRASSLEY. Then, would you say that they are generally satisfied with the prosecutor's support from the Fraud Unit?

Mr. SHERICK. I think that they are satisfied with the prosecutor's support from the Fraud Unit that they are getting on the particular cases that they are working. Again, I have to qualify that by saying that they do have the travel problem.

Senator GRASSLEY. Were you told by any field agents that the FBI agents had informed them they were willing to work with DCIS but refused to work with any cases in which the Fraud Unit was involved?

Mr. SHERICK. I heard that comment, but I do not know where I heard it, and I do not know that it came from the FBI.

Senator GRASSLEY. Is there any reluctance from the field to work with the Fraud Unit?

Mr. SHERICK. I did not find any. I mean, if it is out there, they did not complain to me. As I said, they did complain about the accessibility of some of the attorneys. However, in some places that I went, the Procurement Fraud Unit attorneys were the ones who were working the more important cases.

Senator GRASSLEY. The Fraud Unit was established to prosecute the following types of cases: First, those that are too complex or beyond the interest and resources of U.S. attorneys' offices; and, second, those that involve multiple venues and are beyond the operational jurisdiction of any single U.S. attorney's office.

Do you agree that these are areas where the Fraud Unit was intended to make an impact?

Mr. SHERICK. Yes.

Senator GRASSLEY. OK. Do you think the Fraud Unit record shows it has fulfilled that stated purpose?

Mr. SHERICK. I know that they have worked multiple venue cases, they did it on GTE, and it was a case that should have been worked by the Fraud Unit; I think at least one portion of it came to a conviction.

On providing support in other areas, I think that has happened, too.

Senator GRASSLEY. I would like to defer to the Senator from Pennsylvania, who is under a tight schedule. He has some questions that he wants to submit at this point.

Senator SPECTER. Thank you very much, Mr. Chairman. I, at the outset, commend you for having these very important hearings; I regret that I cannot stay because of other commitments, but I would like to submit certain questions for the record, and to have them answered in writing at a later time.

I appreciate your permitting me to interrupt.

Senator GRASSLEY. I would ask that you would submit the answers in writing within 10 days.

Mr. SHERICK. All right.

[Material submitted for the record follows:] [1]

Senator GRASSLEY. Thank you, Senator, for coming. I know you are under a tight schedule, but you have always been very faithful to the work of this subcommittee and the support of my efforts.

Senator SPECTER. Thank you, Mr. Chairman.

Senator GRASSLEY. You brought up the *GTE* case. I would not have brought that up. But today's St. Louis Post-Dispatch has an article relative to this hearing, and I would like to read the first paragraph:

> Delays by the Justice Department in prosecuting the GTE Corporation for obtaining classified documents from the Defense Department have jeopardized criminal investigations against at least a dozen top defense contractors suspected of acquiring similar documents, investigators close to the case contend.

Is this true? DOJ delays, have they jeopardized future cases?

Mr. SHERICK. I do not think so.

Senator GRASSLEY. You do not think so.

Mr. SHERICK. I think that the *GTE* case was a tough case. Before I was the inspector general, I happened to be the Deputy Assistant Secretary of Defense (Program/Budget), who had the responsibility for the documents that the *GTE* case involved, and I thought they were very important. I thought they certainly gave a tremendous advantage to anybody who got their hands on them.

Senator GRASSLEY. Did they delay in the *GTE* case?

Mr. SHERICK. I am always impatient with prosecutors and investigators. I think that, at least in my involvement in the *GTE* case, in the investigation and the importance of the documents, I think they moved as rapidly as they could move, recognizing that they had a problem, because we had to get some feel for how widespread this was within the Department.

Senator GRASSLEY. How widespread is that?

Mr. SHERICK. I personally do not think it is a widespread problem. I think there were a few people who got access through other people on the inside and who were peddling them to probably several to a dozen contractors, both large and small. But I do not think the paper was all over town. I just do not.

Senator GRASSLEY. All right.

Back to the question I asked you before Senator Specter commenced, whether or not you think the fraud unit's record shows that it fulfilled its stated purpose.

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[1] Not available at press time.

In regard to the *DICS* cases in Philadelphia, why do you think that the Fraud Unit will not relinquish the *DICS* case?

Mr. SHERICK. I do not know. My own opinion is it is probably the numbers game for statistics. I do not know why——

Senator GRASSLEY. Should they be involved in a *DICS* type case; considering their charter and why they were set up, to meet these two sources: one, that they are too complex and beyond the interest and resources of U.S. attorney's offices; or that——

Mr. SHERICK. When the unit started, they got attorneys that came from the military departments to help them. I think they have been through, just as I have been through over the last several years, a training session. I had to train many of the people who came to me from outside the Department of Defense on what the Department of Defense procurement process was about. I think that in order for attorneys to try cases, the Procurement Fraud Unit must act as an instructor to U.S. attorneys who are not familiar with the Defense procurement process.

Senator GRASSLEY. We are talking about a case that is not so complicated that any U.S. attorney would be glad to handle it. And probably——

Mr. SHERICK. Well, I do not want to argue with you about it, but I should say that I think they have to train their people, and this is one case that they could give them.

In those kinds of cases——

Senator GRASSLEY. I need a "yes" or "no" whether or not you think these type cases are the kind that——

Mr. SHERICK. If I were the head of the Procurement Fraud Unit, I would not have my attorneys working on that kind of case.

Senator GRASSLEY. Thank you.

I would like to have you repeat for us what you said about the numbers game.

Mr. SHERICK. You know, I think that we all get involved in a statistics game here, of who is doing what to whom. I think we lose sight of the long-term goal that we are trying to accomplish, that is, a well-trained investigative force, and a well-trained prosecutive force that is going to really go after defense procurement crooks.

We are out there dealing with some very, very sophisticated people who have developed some very, very sophisticated schemes on how to take us to the cleaners, and I do not think that anybody is going to walk out of law school and try those cases. I think it is going to take a complete and consolidated effort, and this is what we have been trying to do——

Senator GRASSLEY. Are we in Government over-matched by——

Mr. SHERICK. Yes; I think so.

Senator GRASSLEY. Mr. Sherick, in commenting about a newly formed Fraud Unit, you said in a January 1983 article, appearing in a Defense magazine, and I would like to quote:

> The success of the Procurement Fraud Unit will depend on the commitment of the two Departments and the talent of those individuals assigned to it. The ultimate impact of the new Fraud Unit will be measured primarily by the significant cases prosecuted.

To repeat one portion, you said the Fraud Unit's success would depend on commitment and talent.

In view of the Fraud Unit's limited successes, would you say they were short on commitment, talent, or both?

Mr. SHERICK. Yes; I testified in April at Mr. Dingell's hearing that I thought they ought to have 70 attorneys. So, you know, I am not convinced that they have got enough people.

Senator GRASSLEY. That is not as simple as just being a research problem, though is it?

Mr. SHERICK. No.

Senator GRASSLEY. It is a resource problem?

Mr. SHERICK. It is a resource problem and a training problem. They have to have good people. The U.S. attorneys have to have the same thing, and they have to be dedicated to going after our cases, which takes, sometimes, years to bring to a conclusion.

Senator GRASSLEY. What good are more attorneys, if the ones they have are not doing their job?

Mr. SHERICK. Well, I think the ones they have are doing their job, there is just not enough of them.

Senator GRASSLEY. It is 2½ years later since you wrote that statement. How do you rate the impact of the Fraud Unit in light of the number of significant cases that it has prosecuted?

Mr. SHERICK. Well, from the standpoint of cases, I am not satisfied; but I think that they have had a very positive impact. I think they have energized a tremendous number of U.S. attorneys to be concerned about procurement fraud cases. I think they have brought——

Senator GRASSLEY. You need a whole new unit with a whole new charter to energize the district attorneys?

Mr. SHERICK. Yes; I think so. That is what it was created for. Because, before that, there was——

Senator GRASSLEY. But have they energized——

Mr. SHERICK. Before that, there was nothing. Yes, I think they have energized the U.S. attorneys.

Senator GRASSLEY. Out there in the field with the U.S. attorneys, you feel that they have?

Mr. SHERICK. Right. I think the U.S. attorneys out there have gotten the message. The competition that the unit creates is a very important element of the whole process. I think the U.S. attorneys have heard the gong, and they want to get in on this area.

In addition to that, I think the U.S. attorneys recognize that the Department of Defense is serious, and that the Department of Defense is willing to commit resources. And we have.

Senator GRASSLEY. I am glad to hear those things, except that it is just what we always hear at these hearings, about "tomorrow is a better day". You know, manana, all the time.

Mr. SHERICK. Well, you know, today is my birthday, and I am 61, and I never really expected to live to see 19. Because I was 17 when World War II started, and I just did not hope to make it. But, you know, in my life, I have never seen anything good done in a hurry. If you really want statistics, they could have run out and done a lot of CHAMPUS cases, or other small cases.

Senator GRASSLEY. I do not want statistics. I want prosecutions.

Mr. SHERICK. No; I am not saying you, I am saying if what the unit wanted was statistics, they could have done medical frauds. But that is not what we wanted them to do, and that is not the

way we directed them, and we knew it was going to take time. It took them a while to get organized.

Again, I am not pleased that they are not out prosecuting more cases; I would like to see them do that. I think they lost valuable time early on, getting organized, getting space, getting the right people. But I still think that they make a very positive contribution, just because they exist.

Senator GRASSLEY. So, what are you saying, that they have done enough or they have not done enough?

Mr. SHERICK. With what they have, I do not think they have committed enough people.

Senator GRASSLEY. So it is a commitment then.

Mr. SHERICK. Absolutely. I think it is a matter of resources.

Senator GRASSLEY. OK.

Senator METZENBAUM. Mr. Sherick, you have been in this business a long time.

Mr. SHERICK. Not in this business, but I have been in business.

Senator METZENBAUM. Well, your activity——

Mr. SHERICK. This is my 44th year, I think, of service to the United States.

Senator METZENBAUM. OK, but before you were the inspector general you were the Assistant Secretary of Defense for Review and Oversight, an administratively created predecessor to the IG position. So that you might appear before us as an expert in prosecuting, bringing to justice Defense Department fraud, I would like you to give me an evaluation, on a scale of 1 to 10, of how you would rate your own Department's activities as of this moment, not yesterday, not tomorrow, but as of now. Would you give yourself a 10?

Mr. SHERICK. No.

Senator METZENBAUM. What would you give yourself?

Mr. SHERICK. I would give myself about a 6.

Senator METZENBAUM. A 6. I think that is very fair, and shows a degree of modesty, certainly, and indicates you are honest.

How would you—what kind of rating would you give the Department of Justice in following through with prosecutions that have been brought to their attention by reason of your Department, your people?

Mr. SHERICK. Well, first, Senator, they are not supposed to prosecute everything we bring them. The major thing that they are supposed to do is to give us advice on the prosecutable merit of what we have, so we do not waste a lot of investigative resources following dead trails.

In that connection, I think that they probably would get about a 5. In the connection of prosecuting key cases on the basis of what they have done—for instance, they did the first cost mischarging case that ever went to trial in Boston, I think that was a very positive accomplishment.

Senator METZENBAUM. Which case was that?

Mr. SHERICK. That was the Systems Architect case. It was the first time anybody had brought one. Actually I think it was done by the fraud section of the Criminal Division of Justice, but Morris Silverstein, who is the head of the Fraud Unit now, was the trial attorney.

They have also taken—the *GTE* case which was an important case that had to do with the integrity of our whole procurement process in the Department.

I probably would give them, from my own point of view, with the resources they had, probably a 4 to a 5.

Senator METZENBAUM. Four to five. And how would you give the Judiciary, how would you rate them as far as handling cases that have been brought to them, either where prosecutions have taken place, and they are then meting out justice to white-collar criminals? Penalties.

Mr. SHERICK. To some of the U.S. attorneys I would give a 10, and some of them I would give a 5 and some of them I would give a 3.

Senator METZENBAUM. Would you give some of them minus three?

Mr. SHERICK. None that I ran into. If you had asked me that question 6 months ago, I would have said yes. I still have a problem down in Miami. We have not had any cases prosecuted in Florida; and I might give them a 0. In others I would—I just visited Boston and New York, and I think both those U.S. attorneys are very definitely up in the 10.

Senator METZENBAUM. No, I am talking about the Judiciary in this last question.

Mr. SHERICK. Oh. The what?

Senator METZENBAUM. The Judiciary.

Mr. SHERICK. Oh, the judges. Well, I think the judges have been great on our cases.

Senator METZENBAUM. Great?

Mr. SHERICK. For instance, in Georgia, where we had the soft armorplate that was sold to us, the judge really came down hard on the individual involved.

Senator METZENBAUM. Let me just ask you, let me go through the list that has been submitted to us, I guess by you people. United States against Rheem, conviction. No sentence. It was February 1985.

United States against DeFrancisco. I think these are all—I think they are connected to that *DISC* case. February 1985, conviction but no sentence.

Anthony Iocono. Conviction, no sentence.

October 30, 1984, conspiracy and bribery, Delcy Fasteners; conspiracy and bribery of DISC Buyers, conviction, no sentence.

Another one, Eastern District of Pennsylvania, conviction $10,000; also a DISC case.

Next one, conviction, 2 years' probation.

Well, there are about seven cases, nobody winds up in jail. Then I get to one, the Systems Architect's case, labor mischarging, mail fraud, false statements and false claims; conviction, 30 days in prison. And my guess is, a part of that was probably suspended.

Mr. SHERICK. Well, I would not give them a 10 on sentencing. I thought you meant——

Senator METZENBAUM. You think that is 10 on sentencing?

Mr. SHERICK. No, I would not.

Senator METZENBAUM. Oh, OK.

Mr. SHERICK. First of all, we do gain something when we try them and that was the area that I was commenting on. In the area of sentencing, I think that some of these people have to go to the slammer, there is no question about it, and I do not think that giving them 300 hours of working at the Boys' Club is anything. I just think that is a joke. I think they should do some hard time, especially the people that are involved in shoddy material.

One of the things I try to do is to convince the judge of the impact of what the individual did to us, the mission impact of their act as opposed to so many dollars. Dollars do not ever tell the story.

Senator METZENBAUM. Dollars do not mean anything to a Defense contractor or to——

Mr. SHERICK. No, what I mean is the mission impact of what they have done. When a man sells us armorplate that is one-fourth the specification; in other words, it is soft, and we put it on a ship that is going into a combat area, somebody deserves prison for that. When somebody sells us parachute shroud line that is made out of 25-year-old nylon tire cord, he deserves to go to jail, and should go to jail.

In addition, the impact on these people who steal from us, when they steal from us, whether it is thousands or millions; in effect, what they are doing is taking money that the American taxpayer is willing to pay to buy military equipment for our use and to be put in our depots in the event of war, and they are just taking that as additional profits, buying themselves a house at the seashore and things like that.

I think that is sabotage. When you deal with defense procurement, I do not think you are dealing with a bank embezzlement, you are dealing with something more important than that.

Senator METZENBAUM. More than money, you are talking about lives, you are talking about security of our Nation.

Mr. SHERICK. That is right. When I go out and visit U.S. attorneys, I do not talk to judges, that is the point I try to make—that they are dealing with something that is different than somebody embezzling his boss for $2,000 or $10,000 or even $1 million.

Senator METZENBAUM. Mr. Sherick, I think both the chairman and I would agree with you, but I think your opening statement, frankly, would lead one to believe that the Justice Department was doing the job.

Now, you are aware of the fact that on July 11 you did get the memo from your own staff in pretty strong language, in fact, unbelievably strong language.

> What good is it to increase fraud referrals if nothing happens with the current referrals? The DCAA headquarters personnel, based on limited information, estimate that of the 400 potential fraud cases referred to DOD investigative agencies over the past 5 years, only 11 resulted in prosecutions.
>
> If accurate, this figure should be of great concern to everyone involved in the process. Such performance, regardless of blame, is undermining DCAA's interest and support of OIG DOD efforts to detect and prosecute procurement fraud.
>
> The DCAA headquarters and regional office personnel have complained to me that the detecting and reporting of fraud is a waste of time. If DCAA is to improve the quality of its fraud referrals, then it needs feedback on the deficiencies in current referrals.

And it goes on.

Now, when your own people say to you that sending the cases to the Department of Justice is a waste of time, then I have to say to you, what did you do after you got that message?

Mr. SHERICK. Well, first of all, I do not think that the message from my people was right. You are talking about two different things—incidentally, and that is the second one. He gave you a report from some particular group in the—I do not know if that is the White House, or where?

Senator GRASSLEY. Within Justice.

Senator METZENBAUM. Justice. Saying that the job is not being done; you said it was not right. Now you say somebody on your own team, whose name is James Curry, Assistant Inspector General for Audit Policy and Oversight, works for you—I gather he works for you.

Mr. SHERICK. Yes.

Senator METZENBAUM. You say he is not right; who is right, Mr. Sherick?

Mr. SHERICK. Mr. Curry agrees that he is not right.

Senator METZENBAUM. Pardon?

Mr. SHERICK. Mr. Curry agrees that he is not right. The problem is one of communications. Mr. Curry did not look at the other side of the problem; that is, go out in the field and see what was happening. I did, and I found out that lots of things were happening now that we finally have DCAA doing the job. I understood early on that investigators and prosecutors cannot do anything unless the auditors are out there on the first line of defense, looking for the fraud. They are the people in the factory, they are the people that are watching the contractor's schemes and watching the contractor's accounting system.

Senator METZENBAUM. OK.

Mr. SHERICK. One of the first things we did was we went out and looked at, one, the auditors access to records and, two, referral of fraud because I understood that this was an area that was very, very important to the whole process.

The first thing we found was that in many cases they did not even have access to the records. The contractors were telling them, take a walk, and they were taking a walk. So we criticized them for that and told them to get with it, and get access to the records.

The second thing that we criticized them for was referrals. The number of referrals was absolutely minimal. They didn't want to get involved. They did not consider themselves investigators. They did not want to be "audigators," and they felt that by referring suspected fraud to the Department of Justice and to the criminal investigators, it injured their relationship with the contractors. We said, "We do not care about your relationship with the contractors. You are auditors, who work for the Department of Defense and the U.S. Government, and if fraud exists we want referrals." We energized referrals.

What that letter did not say is that most of those referrals were within the last 18 months, and most of those referrals are still in the process of being worked. Now, the major problem we had, from the very beginning with DCAA, was a question of communications. The auditors generally did not want to know what happened after making referrals. This amazed me because I did not understand

how somebody who sees a contractor steal would not really want to know what happened. But they really were not interested. Now they are interested. And I think that the big problem that Jim Curry was identifying was that nobody was telling some DCAA auditors what was happening on those cases which they had referred. The only cases they knew about were those cases where the auditor was actually working with the prosecution. In other words, they were used as witnesses or assisting the investigators.

When I go out and visit my office, as I did just recently, in every office I was at there was a DCAA auditor or several DCAA auditors working right in the office. In fact, we have got them on the team.

Senator METZENBAUM. Well, what is your point? I do not understand your point.

Mr. SHERICK. My point is that there was a lack of communication. That some of the auditors did not know what was happening, and, therefore, they felt nothing was happening.

Senator METZENBAUM. Are you telling me, us, that there are that many prosecutions taking place? I have a very——

Mr. SHERICK. Yes, I would say there are that many cases referred to the Fraud Unit by DCAA. Now, every audit finding does not necessarily mean the contractor is stealing. But what we are training them to do is say, "Hey, if you see anything that might look like fraud, you tell us."

Senator METZENBAUM. Well, you said that they talked about 400 fraud referrals.

Mr. SHERICK. Fraud. Fraud means intentionally misrepresenting, misleading——

Senator METZENBAUM. Yes, with an intent to defraud.

Mr. SHERICK. Well, what we try——

Senator METZENBAUM. With an intent to do so.

Mr. SHERICK. That is one of the things that I talked about in our training program. One of the things we are trying to do is to make our auditors aware of what fraud is. And we have run training programs for hundreds of them, to try to make them understand what fraud is.

We have done that, so that they can make fraud referrals. So what we ask them to do is, whenever they even suspect it, when they see something that is in any way questionable, refer it to us, refer it to the criminal investigators, the people who are trained to know what fraud is, and let them review it. And that is what they are doing. I think it is a very positive thing. We encourage them to do that.

Senator METZENBAUM. You know, as the chairman says, what you are saying is that mañana is going to be better than yesterday. And the fact is there is no evidence of that.

Mr. SHERICK. Oh, yes; there is.

Senator METZENBAUM. We just read about General Electric just being let off the hook and being qualified again to get defense contracts. Nobody goes to jail.

We see the same thing happening with General Dynamics.

Mr. SHERICK. Well, I cannot answer that. I did not do that. I agree with you on that. I like to see people indicted, I like to see people convicted, I like to see people go to jail for crime.

Senator METZENBAUM. I must say to you that I think it is one of the most unbelievable situations that I have read about. General Dynamics is now a big cause celebré because one of its officers, 10 years ago, was involved in some sort of alleged bribery, was not even found guilty, and all of a sudden he is made the—that is the big issue, that is really getting tough. But the continuous ripoff of the U.S. Government by the defense contractors, those are not prosecuted, those people, those companies are requalified to do business and there are so many of them that it just reads like a list of America's top 20 in the Fortune 500 list, and nothing happens to them.

Mr. SHERICK. Well, I can assure you, Senator, that the convictions that occurred were over in Philadelphia, and these were all little league players, I might say, not the big defense contractors of the country.

You know, in my statement, I indicated that we had many convictions, in the first half of this year. I mean the numbers of convictions are going up, the numbers of indictments are going up. And I think that our effort is paying off.

Senator METZENBAUM. Let me ask you this: The Justice Department has, on several occasions, entered into so-called global settlements, where all frauds, known or unknown, prior to the guilty plea, are excused. What are your views to that kind of settlement?

Mr. SHERICK. I do not like global settlements. I think that they are ridiculous.

Senator METZENBAUM. In Sperry, the Department of Justice urged the Pentagon not to debar Sperry. What do you think of that kind of procedure?

Mr. SHERICK. Well, debarment and suspension is not considered a punishment. They say that we do not want to do business with you, but we are not punishing you; we just do not want to do business with you because there are other people we can do business with.

I personally feel that we get ourselves wrapped around an axle when we talk about companies. There is no question it is good to suspend or debar a company, but what happens is, that the company puts up its 19,000-employees as a hostage, and they say, in effect: If you suspend or debar me, 19,000 people are going to be out of work. And these 19,000 people did not do anything. I mean, a few of them may have, but most of these people, blue-collar people working in the shipyard or working wherever in a factory, they did not do anything to the U.S. Government. They are doing good work. But you are going to punish them by putting them out of a job.

I personally think that that is true, that we should not put the 19,000 people out of work; what we ought to do is go after the people at the top, the management, and the people that were involved, and suspend and debar them, get rid of those guys, fire them.

Senator METZENBAUM. How about suspending and debarring them and prosecuting them and sending them to prison?

Mr. SHERICK. Absolutely. But I still think suspension and debarment for poor management is what we should be after, and we should go after individuals, and I recommended that in the *General Dynamics* case. But the point is, as long as we let these contractors

use their 19,000-person work force as a hostage, we are not going to ever get the people out of the management of the company that are responsible for what is happening.

Senator GRASSLEY. Are you pressuring DOJ at all about your view on global settlements, that——

Mr. SHERICK. They know my view. I made my view very clear.

Senator GRASSLEY. To what extent do you feel they are listening to you?

Mr. SHERICK. I think they are listening.

Senator METZENBAUM. Mr. Chairman, I might have some more, but I am sort of looking at the Department of Justice people who are still to come on, and I know we have to quit about 12; I think we ought to give them a chance to defend themselves, because, frankly, I think they need defending—although I do not know what kind of defense they might have.

Senator GRASSLEY. All right. We have talked about the Fraud Unit's record, and now I would like to talk a bit about the Defense Criminal Investigative Services record. For instance, it obtained just 45 contract fraud convictions across the country in 1984. And let me stress that these were contract fraud matters.

The total dollar amount recovered as a result of those cases amounted to just $3½ million. In that same year we spent $133 billion on Defense contracts; and $92 billion of that $133 billion went to the top 100 defense contractors.

In 1984, do you know how many of the top 100 Defense contractors were prosecuted? Just one.

Mr. SHERICK. Sperry, I guess.

Senator GRASSLEY. Do you not think that this record sends a message to major contractors that they do not really have to sweat this so-called crackdown on defense fraud?

Mr. SHERICK. I do not know. A lot of them are calling me an awful lot of names, and sweating, and they are hiring a lot of very expensive law firms to handle the kinds of cases that we are bringing against them. I think you have got to remember that this defense unit that was created from nothing. I mean, there was no Procurement Fraud Unit in the investigative arm of the Department of Defense. We had to build it from nothing. The Congress initially said 100 agents would do the job. I immediately recognized that 100 agents was a bump on a log, that we had to move certainly way far away from that.

The second thing we had to do was energize the military investigators. For instance, GAO did an audit and found that 67 percent of the frauds that were investigated by the Military Departments involved $500 or less. That the criminal investigators in the Military Departments were looking at barracks theft, and who broke open the Coke machine. Nobody was looking at the contractors.

So, one, we had to bring on people who were criminal investigators who understood what procurement fraud was about, or at least knew how to deal with paper, because that is what my people deal with. Paper. Records.

Senator GRASSLEY. Let me clarify. You said 45 of the 100 biggest Defense contractors are under investigation. Is that active?

Mr. SHERICK. Yes; it stays in that area. Some cases are closed, others opened.

Senator GRASSLEY. Really active investigation?

Mr. SHERICK. I think the number goes from one extreme to the other. It ranges anywhere from 36 up to 46.

Senator GRASSLEY. With all due respect, I do not know whether to put a lot of faith in that claim. I would like to quote for you from the Pittsburgh Press, dated July 12, 1984, as to whether or not these claims about tomorrow being a better day—says the Pentagon's inspector general, criticized for going after nickel-and-dime fraud cases while leaving the big contractors alone, says he expects criminal indictments this fall for investigations of about 15 major contractors.

Now, I also notice that Mr. Weinberger picked up on your prediction and claimed in a speech that same month of July 1984 that we would see 15 major Defense contractors indicted in the fall of 1984.

Now, if my memory serves me correctly, not only did we not see 15 indictments of major contractors last fall, we did not see any, and I think we have only seen one or two since then.

Where did that prediction of 15 indictments come from?

Mr. SHERICK. My own agents predicted indictments beginning in the fall of 1984 and that is what I told the Pittsburgh Press. The article cited quotes me as saying that "A lot of them (investigations of major corporations) are in grand jury, and we expect we're going to see some * * * indictments around September. I think, looking at the cases we have, we've got at least 15 good, solid cases." The reporter misinterpreted me if he understood that I believed that all 15 indictments were expected in the fall.

Senator GRASSLEY. Your own agents.

What happened that the indictments were not carried out, then?

Mr. SHERICK. Well, you know, they keep telling me stories. There are a lot of excuses, and that is one of the things that makes me very, very impatient. And that is one of the reasons why I have been going around stirring up the pot, trying to get action on my cases, more action. And I know the cases are there, very definitely they are there.

Senator GRASSLEY. Mr. Sherick, at this point I would like to excuse you from the witness table, but ask you to remain, so that I may call you for some additional testimony or questions after we hear the next testimony.

Before I call the Department of Justice, I would now like to call Mr. Robert Segal as a witness.

Mr. Segal, I apologize for delaying a confirmation of your testimony, but I asked my staff to look into your credentials. I hope you are not offended that we checked out your credibility, but you might be pleased to know the reports we received indicate your investigative talent and especially your expertise in the complex crime area is highly regarded.

Mr. Segal was an agent in the Contract Fraud Division of the DOD Inspector General's Office from 1983 through 1985. Mr. Segal is a regular lecturer on complex criminal investigations at the FBI Academy, and for the International Association of Police Chiefs.

Mr. Segal, I would like to thank you for agreeing to come here today and give us the benefit of your expertise in the Defense fraud area, and I would like to have you rise so that I can swear you in.

Do you swear to tell the truth, the whole truth and nothing but the truth, so help you, God?

Mr. SEGAL. I do.

Senator GRASSLEY. Would you proceed, then, with your testimony?

STATEMENT OF ROBERT SEGAL

Mr. SEGAL. I would like to begin by thanking you for the opportunity to appear before this committee. There is a very simple reason why I am here today. A friend once told me that either you are a part of the solution or you are part of the problem. I am here today hopefully to be part of the solution to a very real and serious problem, the inability of the DOD and DOJ Procurement Fraud Unit to have a significant impact upon fraudulent conduct within the defense procurement industry.

The views I express today represent my professional evaluation of the PFU performance. These views were formed as a result of my firsthand experience working on a day-to-day basis with that Unit from October 1983 through January 1985, during which time I had the responsibility of coordinating all defense criminal investigative service cases referred to the PFU for prosecution.

When I joined DCIS, I brought with me a wealth of investigative expertise, particularly in the area of complex criminal investigations. That expertise was formed through my 11 years experience as an investigator with the Department of Justice.

My skills in the area of complex criminal investigations have received frequent recognition, including seven DOJ awards, and most recently a memorandum of commendation from Mr. Joseph Sherick, the DOD inspector general.

I accepted my assignment to coordinate the DCIS cases being handled by PFU with great enthusiasm. I immediately recognized the tremendous potential the PFU had for significantly impacting fraudulent conduct within the defense procurement community.

However, my excitement and enthusiasm were both short-lived. I soon discovered that there were major problems within the very makeup of the PFU which greatly reduces potential for having any serious impact upon defense procurement fraud.

Senator METZENBAUM. What is the PFU, Mr. Segal?

Mr. SEGAL. The DOJ Procurement Fraud Unit, I apologize. I am referring to the unit that was discussed here earlier, set up to handle the DOD cases.

I soon discovered that there were major problems within the very makeup of the PFU which greatly reduced its potential for having any serious impact upon defense procurement fraud. Examples of PFU inadequacies abound.

However, the recent *GTE* case clearly demonstrates the magnitude of the problems at the PFU and within DOJ itself. The guilty plea by GTE resulted from an extensive investigation originated by DCIS more than 2 years preceding the GTE plea. This case was transferred by DCIS to the PFU for prosecution because DCIS——

Ms. TOENSING. Mr. Chairman, on behalf of the Justice Department I must say something to you right now, that we are very con-

cerned because this is an open case. There are three individuals charged in this case and we do not want this prosecution harmed.

Senator METZENBAUM. Will you tell us how this man, who is not a party to the prosecution and who has done his own independent investigation, how in any way he could harm that prosecution?

Ms. TOENSING. If I knew what he were going to say——

Senator METZENBAUM. What I was going to say or he was going to say?

Ms. TOENSING. I do not know what he is going to say, and so as the prosecutor on this case, I have to protect my case.

Senator METZENBAUM. I understand that, but what I am saying to you is that as a former practicing lawyer I do not understand how what some one individual might say who is unconnected with the Government, how he would be harming your prosecutorial position.

Ms. TOENSING. I was told, Mr. Chairman, that he was going to talk about the *GTE* case. If that is inaccurate, and he is not going to talk about the *GTE* case, then I have no problem. The problem I have is that, and I am sure you may not be aware of it because you have said publicly that there were no individuals charged in *GTE*, but in fact, there were three charged.

So even though the corporation pleaded guilty, there are three individuals yet to go to trial.

Senator METZENBAUM. Mr. Segal, were you involved as part of the Government team in investigating the *GTE* case?

Mr. SEGAL. Yes, sir. In fact, I ran the investigation for about 6 months. I would like to add, Senator, that I have no intention of giving any public testimony that would, in any way, damage that case. I have as much a vested interest in it as the prosecutors have.

Ms. TOENSING. Mr. Chairman, I would respectfully ask that nothing be said at all regarding *GTE*. Then I have no problems, but I am very concerned about our case. We care about that case, and we do not want to be faced with motions in court tomorrow morning that say we prejudiced that case because testimony was allowed and we discussed it publicly, or that anyone discussed it publicly. I have to protect my case.

Senator METZENBAUM. Will you explain to me how his testimony might, in some way, affect that case tomorrow? Because of pretrial publicity or by reason of what? I am not quite certain of the legal theory that——

Ms. TOENSING. Discussing the intricacies of an investigation is not permitted when the case has not yet gone to trial. The corporation pleaded guilty, Mr. Chairman, but there were three individuals indicted, and you may not be aware of that.

Senator METZENBAUM. I am aware of that. I am aware of the fact three individuals have been indicted, and I am aware of the fact the corporation pleaded guilty, and I think, if my recollection serves me right, paid a very modest fine. Am I correct about that?

Ms. TOENSING. I do not think there has been a sentence yet in that case. It is my understanding that there has not been a sentence. They paid a criminal fine.

Mr. Chairman, perhaps I could make it easier because I do not have a problem with your getting any information about this out of the public forum. I would like to make an offer that we meet with

you out of the public view and you can get whatever information that you need from this gentleman regarding GTE, but I do not want my case to be harmed.

Senator GRASSLEY. Would you come to the back room, Mr. Segal and Ms. Toensing.

[Whereupon, a short recess was taken.]

Senator GRASSLEY. I would call the recess to a close and say that I am going to have the witness temporarily stand aside. We will call you for later testimony. The reason for that is we do not want any activity that we are conducting at this committee hearing to in any way affect the *GTE* case.

So we thank you very much for coming forward. We appreciate the time you have taken to be here, and we expect to hear from you in the future. Thank you very much.

I would like to have Mr. Sherick come back and I would like to have your agents come with you.

Mr. SHERICK. Yes, sir.

Senator GRASSLEY. I have some wrap-up questions. This subcommittee has interviewed every agent in your headquarters Contracts Fraud Division as well as agents in the field. One concern raised by a majority of your agents is that direction and priority setting is missing at the top level of DOD.

In other words, agents are unsure which cases will not be a waste of time to pursue. Why have clear priorities not been set for attacking the procurement fraud problem?

Mr. SHERICK. I think I have set clear priorities. I do not understand why they do not understand them. I have said to them so many times, and I think I have a meeting of the minds with the head of my procurement investigative group.

My priorities are pretty clear. Product substitution is No. 1. Cost mischarging, defective pricing is No. 2, and right down the line. I do not make any bones about what I think is important.

Senator GRASSLEY. How do you explain that the agents do not feel that any priorities exist?

Mr. SHERICK. I do not know what I have to do. Certainly in the field my agents understand what the priorities are because I have been out there. I look at the cases they are working. As I say, I just came back from a whole series of trips, and they know that the first thing I want to talk about is product substitution. The second thing I want to talk about is cost mischarging and defective pricings. My auditors know what my priorities are. Why my administrative agents in my headquarters do not know, I cannot answer for you. I think I have made it perfectly clear what my priorities are, and they are working in accordance with my priorities.

Senator GRASSLEY. In testimony before the House Energy and Commerce Committee last April, you indicated that you had 427 contract fraud investigations underway, and I would like to quote, "And I keep pounding them to the Procurement Fraud Unit. The only thing you can do from that point on is make a lot of noise."

Mr. SHERICK. That is right.

Senator GRASSLEY. I would like to have you answer three questions related to that statement. Can you explain how you are making a lot of noise? Are you getting any results? And what are those results?

Mr. SHERICK. The way I am making a lot of noise is first going out and seeing the U.S. attorneys. As I said, I do not think that four attorneys in the Procurement Fraud Unit are going to, in any way, cover the kind of cases and the number of cases that I want. I am going out and I am talking to the U.S. attorneys. I am meeting with them. I am meeting with the procurement people and I am meeting with the AUSA's that they have assigned, and 23 of them have, in effect, designated people as defense procurement fraud prosecutors. I continue to put as many resources as I can possibly put into the procurement fraud area in terms of auditors and investigators.

One of the things I did early on when I first became inspector general was to rearrange certain priorities. For example, only about 11 percent of our audits were directed at procurement. It is now 64 percent. We did one of the largest procurement audits in the history of the Department of Defense, in fact, the largest on spare parts. We looked at the 202 largest suppliers of spare parts in the United States, and we went out and looked at the contracts, the pricing and the way they handle their contracts and their proposals for these spare parts. The Department of Defense buys about $22 billion worth of spare parts every year.

Senator GRASSLEY. Are you getting any results from that?

Mr. SHERICK. Yes, of the 202, we found that over 95 had overpriced us. First of all, we are going for refunds, and the Department is getting refunds. Second, we have gone back now, and we are doing a line-item audit of every one of the 95, not just the sample that we looked at, but everything they sold us over a 3-year period, to find out what they did in terms of overpricing. Was there defective pricing?

We are finding a lot of overpricing and we are finding a lot of defective pricing, and that, in turn, becomes referrals for investigations. So I think that we redirected the audit operation toward procurement, and that is where the cases are made. The auditors make the cases. The auditors come up with the facts that then become investigated and become the cases that the Procurement Fraud Unit sees.

I have done everything I possibly can to find out what the shortages are in numbers of agents. As fast as we can hire people, we are hiring them.

Senator GRASSLEY. You have indicated in the past your frustrations with prosecutors who neglect DOD fraud cases. You have also indicated that you use your authority to persuade prosecutors to act.

In fact, earlier this year you testified before the House committee, and I would like to quote. "We send them letters. We call them up. We talk to them. We do everything we can but stand on our heads because, you know, that is our job to try and get our cases handled."

I believe this quote came during a conversation about the lack of prosecution stemming from the Los Angeles U.S. attorney's office.

Mr. SHERICK. Right.

Senator GRASSLEY. Yet, Mr. Sherick, you did not send a letter to that office until after——

Mr. SHERICK. Yes, I did.

Senator GRASSLEY. You did?

Mr. SHERICK. Sure.

Senator GRASSLEY. Well, yes, after your congressional testimony and, in fact, after I had written that office on April 13 with those same concerns. Why did you take so long to act then?

Mr. SHERICK. I did something about the problem, as soon as it was brought to my attention, I am only one man. I can do only so much, but when I find a problem, I do something.

Senator GRASSLEY. Did you ever discuss the lack of prosecutions in California with Secretary Weinberger?

Mr. SHERICK. Yes, I talked about the lack of prosecutions across the board with the Department of Justice early on as one of the major problems, and that is why the Defense Procurement Fraud Unit was created.

Senator GRASSLEY. Let me read to you what one of your staff told this subcommittee: "Sherick does not exert the pressure he could. Just about every letter that the DCIS input is watered down by the time it goes out, if it goes out."

Are you more concerned about preserving good relations with the Department of Justice than getting the cases prosecuted?

Mr. SHERICK. You know, I do not know who that person was, but whoever it was is a liar.

Senator GRASSLEY. Your office was involved in the investigation of the mischarging of the Sperry——

Mr. SHERICK. I do not think I have ever changed a letter that came to me from DCIS.

Senator GRASSLEY. OK. Has any of your staff changed them?

Mr. SHERICK. I do not know. I see the letters when they come to me. I sign them.

Senator GRASSLEY. Mr. Sherick, your office was involved in the investigation of mischarging at the Sperry Corp. facility in Minneapolis. As you know, the resolution of that case came in a negotiated settlement approved by the court in May 1984.

Sperry ultimately agreed to pay $30,000 in criminal fines plus double civil damages. DOD agreed not to suspend or debar Sperry. Were you satisfied with the outcome of this case and the terms of the settlement?

Mr. SHERICK. No; I was not satisfied with the plea agreement. I try to stay out of suspension and debarment because it is not my business. I always have my view on suspension and debarment, but that is not a punishment, and it is supposed to be the business managers of the Department of Defense deciding who they want to do business with.

Senator GRASSLEY. Did you or members of your staff review the Sperry plea agreement?

Mr. SHERICK. No.

Senator GRASSLEY. Why not?

Mr. SHERICK. It was not brought to me.

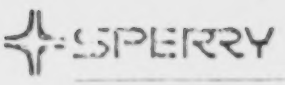
Senator GRASSLEY. Are you familiar with a subsequent criminal investigation of Sperry at its Salt Lake City facility?

Mr. SHERICK. Yes.

Senator GRASSLEY. I would like to enter in the record a letter from Sperry counsel dated September 5, 1984, indicating that the settlement reached in the Minneapolis case excused Sperry from

any mischarging at its Salt Lake City facility even though the Government had already negotiated a plea agreement with Sperry before this mischarging occurred.

[Material submitted for the record follows:]



SPERRY CORPORATION
COMPUTER SYSTEMS
SPERRY PARK P O BOX 43525
ST PAUL MINNESOTA 55164-0525
TELEPHONE (612) 456-2070

DARRELL L LYNN
Assistant Counsel
Law Department

HAND DELIVERED

September 5, 1984

Mr. Brian M. Bruh
Assistant Inspector General and Director
Defense Criminal Investigative Service
8D468 Cameron Station
Alexandria, Virginia 22314

Dear Mr. Bruh:

The Defense Criminal Investigative Service has initiated an investigation of the Microwave Data Transmission Systems ("MDTS") located in Salt Lake City, Utah. MDTS is a facility of the Defense Systems Division, Computer Systems, Sperry Corporation. This investigation was apparently prompted by a recent DCAA audit of labor charging practices at MDTS covering CY 1983 and the first three months of 1984. The facility, the labor charges, and the time period covered by the audit are all encompassed by the recent Plea Agreement and Agreement between the Department of Defense and Sperry Corporation relating to no suspension or debarment.

These Agreements were expressly conditioned on each other and neither became effective until the Plea Agreement was accepted by the Federal District Court in Minnesota on May 22, 1984. (A copy of the agreements is attached.) Paragraph 3 of the Plea Agreement provides:

> 3. It is agreed that other than as set forth in this Agreement the United States Department of Justice will not prosecute Sperry for any criminal violation of the United States Code for any conduct relating to the mischarging of labor costs, travel costs, or related expenses at DSD which occurred prior to the date of this plea agreement. (Emphasis added)

Further, a central component of the Agreements between Sperry Corporation and the Government was a comprehensive improvements plan to ensure the future integrity of DSD's labor charges to Government contracts. The current investigation covers a period

prior to implementation of these improvements. Past inadequacies in DSD's labor charge system were implicity recognized and were dealt with in creating the improvements plan. Revisiting DSD labor charging practices prior to implementation of these improvements serves no constructive purpose.

The DCIS investigation of MDTS is a waste of resources, and violates the spirit of the Agreements between the Government and Sperry Corporation. In view of these circumstances, we believe the investigation should be discontinued.

Sperry Corporation, of course, stands ready to cooperate with any reasonable and legitimate inquiry. We do object, however, to the manner in which DCIS has attempted to conduct its investigation over the past several weeks. There is no need to disturb employees by visits to their homes, or to disrupt their work with calls to their offices. If you wish, the Defense Systems Division will arrange, as it has in the past, interviews of its employees on Defense Systems Division premises during normal working hours. These procedures must, however, safeguard the employees' rights, including their right to have counsel present during such interviews.

A copy of this letter is being given to Morris Silverstein, Esquire, Chief, Defense Procurement Fraud Unit, Criminal Division, U.S. Department of Justice.

We would appreciate an opportunity to discuss this matter with you or your staff.

Sincerely,

Darrell L. Lynn

Darrell L. Lynn

DLL:kw
Attachments
cc: Morris B. Silverstein, Esq.

Special Agent Ken Hoyal
Ogden, Utah (w/o attachments)

Senator GRASSLEY. I would also like to enter in the record a letter dated November 12, 1984, from Sperry counsel to the Assistant Inspector General for Criminal Investigation, and the letter reads,

Mr. Morris Silverstein, Chief, Defense Procurement Fraud Unit.

Informed our outside counsel on September 21, 1984, that he agreed with our interpretation of the plea agreement and that the criminal investigation of Microwave Data Transmission System in Salt Lake City would be discontinued.

[Material submitted for the record follows:]

[illegible]

[illegible] CORPORATION
COMPUTER SYSTEMS
[illegible] PARK P. O. BOX [illegible]
[illegible] MINNESOTA [illegible]
TELEPHONE [illegible]

DARRELL L. LYNN
[illegible]
[illegible]

12 November 1984

Mr. Brian M. Bruh
Assistant Inspector General
for Investigations
Department of Defense
Inspector General
P.O. Box 9290
Alexandria, Virginia 22304

Dear Mr. Bruh:

Your letter of September 13, 1984, stated that a reply would be forthcoming to the legal issues raised in my September 5, 1984, letter to you. Morris B. Silverstein, Chief, Defense Procurement Fraud Unit, informed our outside counsel on September 21, 1984, that he agreed with our interpretation of the Plea Agreement and that the criminal investigation of Microwave Data Transmission Systems [MDTS] in Salt Lake City, Utah, would be discontinued.

DCAS and DCAA representatives have been asking about the status of the investigation. I would appreciate your confirming that the criminal investigation of MDTS has been discontinued.

Sincerely,

Darrell L. Lynn

Darrell L. Lynn

DLL:lj

Senator GRASSLEY. Mr. Sherick, in your opinion, do you think we should be entering into these types of across-the-board immunity agreements?

Mr. SHERICK. No. I thought that was a disgrace. That is why I do not go for global settlements. I think that global settlements such as this are a travesty.

Senator GRASSLEY. Do you think contractor influence is a problem when, for instance, contractors take Department of Defense employees on fishing trips, buy them jewelry, host lavish weekends at tropical resorts?

I guess these could all fall under the umbrella of gratuity.

Mr. SHERICK. I think that that is disgraceful. I do not think Government employees should be offered that kind of corruption, and I certainly think they ought to be bright enough not to take it.

Senator GRASSLEY. What should be done to make an impact on these cases?

Mr. SHERICK. I would like to see some people go to jail myself, especially the people who corrupt the people who push the trips and push the presents, et cetera.

Senator GRASSLEY. Is the Department of Justice willing to prosecute these cases?

Mr. SHERICK. I have not seen much willingness on the part of the Department of Justice to jump in and take the lead on the gratuities cases. Recently, they have shown more of an interest.

Senator GRASSLEY. So they are going to go after these cases now?

Mr. SHERICK. They are asking us to do more investigations and I would say that hopefully they are going to go after some of them.

Senator GRASSLEY. How many gratuity cases have you investigated?

Mr. SHERICK. I know that there have been several. Emerson, I think, out in Ohio was one which the material is all in grand jury, and there were probably others, but I am not familiar with every case. I would have to put that in the record.

Senator GRASSLEY. Are those involving major contractors that you are talking about?

Mr. SHERICK. Well, Emerson was, and I think Pratt and Whitney is another one down in Miami. That is in the U.S. attorney's office down there.

Senator GRASSLEY. How come the Pratt and Whitney investigation has not lead to prosecution?

Mr SHERICK. I do not know. It is a mystery to me.

Senator GRASSLEY. I know your agents spent considerable time on a case involving Aerojet Propulsion Co. and its entertainment of DOD officials. Specifically Aerojet hosted hunting and fishing trips costing several hundred dollars, and then charged them to the Government. These were trips for Defense Department employees. Why do you think the Department of Justice refused to prosecute?

Mr. SHERICK. I think most of the people involved in that, at least the record that I saw, were congressional staff members. The balance of them were legislative liaison people from the Department of Defense who accompanied the congressional members.

Senator GRASSLEY. Just let me clarify the record. There were Department of Defense employees involved?

Mr. SHERICK. That is right. They were legislative liaison people.

Senator GRASSLEY. And am I right? They work for the Government just like everybody else does?

Mr. SHERICK. Yes.

Senator GRASSLEY. The same laws apply?

Mr. SHERICK. Yes; the three people involved, I think, work for the Army and the case was referred. I think about $200 was the total amount for the Army employees.

Senator GRASSLEY. What are you going to do to make sure that the Department of Justice addresses this case?

Mr SHERICK. We got a denial on that. We went both to the Procurement Fraud Unit and to the Public Integrity Section, and we got a declination from both.

Senator METZENBAUM. Declination means that they do not want to do anything about it?

Mr. SHERICK. That is right.

Senator GRASSLEY. I did concentrate on that one case, Aerojet Propulsion, but what about these types of cases generally? Are you going to do anything to make sure that the Department of Justice does address them?

Mr. SHERICK. You know, all I can do is ask. I am not the Attorney General, I am the Inspector General, and I can make noise, and that is about the limit of what I can do. I personally think that these cases should be prosecuted.

I certainly do not want to waste my time investigating cases that I do not have any hope of getting a prosecution on. I am supposed to stop fraud, waste and abuse, not do it.

Senator GRASSLEY. I would like to pose another situation of contractor influence. What about when a major contractor allows five of his employees to take high-level Department of Defense positions and then gives the former employees, quote unquote, a little something to remember the contractor by over the next 5 years, a little something to the tune of $300,000?

You probably do know that I am referring to the case involving Boeing and several DOD employees, including Assistant Secretary of the Navy Melvin Paisley. It is kind of a new wrinkle in a revolving door, would you not say?

Mr. SHERICK. I do not know if it is a new wrinkle or not. I am not that familiar with the way severance pay is handled; but I would doubt that somebody invented a new wrinkle this late in the game. I mean, this kind of stuff has been going on since the Revolutionary War; that is why they had Baron von Steuben.

Senator METZENBAUM. May I respectfully suggest to my distinguished colleague and Chairman, maybe the reason the Justice Department did not prosecute those so rapidly is because—that is, those severance bonuses—was because the Attorney General himself received one. I do not mean Mr. Meese, I mean Mr. Smith. You will recollect that he received a $50,000 payment after it had been announced he was going to head up the Department of Justice, or the Attorney General's Office, become Attorney General.

So, maybe it pervaded the whole Department that if the Attorney General can do it, maybe others can do it as well.

Senator GRASSLEY. Well, Mr. Sherick's staff spent more than a year working with the Department of Justice on developing a case,

only to have the Department of Justice decide it did not want to prosecute the whole thing, after all.

Are we saying here, Mr. Sherick, that this type of influence is OK?

Mr. SHERICK [laughing]. You do not hear me saying that. Anybody that says I say that you can take handouts from a contractor needs his bolts tightened. I think that that is the way you really undermine the integrity of the whole procurement process. And when people that work for the Government start thinking that they owe a loyalty to somebody else, we do not have any hope.

Senator GRASSLEY. Well, that is the last question I have for you at this point, and I want to thank you very much.

I would say that I appreciate very much your cooperation, particularly when I asked you to allow my staff to visit with some of your people; I appreciate that very much. Thank you.

Mr. SHERICK. I regret that I was not there to hear them talk. It seems to me that your staff went out to talk to my people and came back with some stories that I think were out-and-out lies. I resent that, and I certainly resent some of my own people doing that, because the one thing I have done ever since I got this job is to support fully my criminal investigators. They never have asked me for support that they did not get. They have never asked me for additional resources that they did not get.

Certainly after 43 years in the Government, it makes me sick when I understand that some of my own people are out there telling lies and back-dooring me.

Thank you.

Senator GRASSLEY. I would hope that you would not be in any different position than I am. I tell my staff that I do not need to know the good things I am doing, all I need to hear are the bad things.

Mr. SHERICK. That is basically my own view, and I have listened to them and supported them every time, and I just resent the fact that they sit out there and do that. I am sure it is a very small minority, and I am sure it is people with very tender egos.

In this business, that is one of the things you have to worry about, you are dealing with people with tender egos, you are dealing with prosecutors, criminal investigators, auditors, each one of them thinks that they are professionals, and they think they have a certain ability that the other guy does not understand. One of the major things that we have to do in this Government is get that group of people to work together without standing around throwing rocks at each other.

I think one of the things we see here today is just the result of that. Everyone thinks they know how to do it best, and nobody wants to be part of the team. That is unfortunate, because I think the taxpayers are the ones that are getting their clocks cleaned, and they are paying people to go out there and do a job, and it is not being done because of that problem of cooperation.

Senator GRASSLEY. Thank you, Mr. Sherick.

Our purpose of this hearing is because there have been certain statements of accomplishment and we do not think the record reflects that. Our purpose is to review that record, to see whether or not an agency, set up to do a specific job, is doing that job.

[Prepared statement follows:]

PREPARED STATEMENT OF JOSEPH H. SHERICK

I am pleased to appear before the Subcommittee today to discuss the Office of the Inspector General, Department of Defense, and the investigation of procurement fraud cases in the Department of Defense.

As general background, let me begin by describing the short history and organizational structure of my office, as well as some general data on the Department of Defense and its operations.

The Defense Inspector General was established in September 1982 as a provision of the FY 1983 Defense Authorization Act. I was confirmed as Inspector General on May 20, 1983, just over two years ago. Prior to being designated IG, I served from June of 1981 as Assistant to the Secretary of Defense for Review and Oversight, an administratively created predecessor to the IG position, established by Secretary Weinberger in May of 1981.

The DoD IG was established to provide and coordinate audit, investigative and inspection support to the Department's activities located throughout the world and to monitor and evaluate the Department's programs and operations. The DoD as an operating agency dedicated to the military defense of the nation spends about $600 million every day of the year--Saturdays, Sundays and holidays. To carry out our mission we have 5,500 installations or activities located in the United States and 21 countries around the world. We employ about 6.3 million personnel directly or indirectly including Service members, Government civilian workers and those in defense industries. We have over 4 million cataloged items in inventory. In FY 1984, we had 15 million contract actions worth $146 billion and dealt with 60,000 prime contractors. In FY 1984, 23 companies did more than a billion dollars of business as prime contractors with DoD, over 100 did $100 million or more.

To assure these vast resources are managed wisely, the Department employs 19,400 auditors, investigators and inspectors. About 900 of these people work directly for the Defense Inspector General. The remaining auditors, investigators and inspectors are under the direct operational control of the Military Departments, but fall under the policy and oversight responsibilities of the Defense Inspector General.

INSPECTOR GENERAL ORGANIZATION

The Inspector General is assisted by six Assistant Inspectors General, each responsible for carrying out a specific portion of the Inspector General's assigned mission.

Auditing

The Assistant Inspector General for Auditing performs internal audits of the programs and activities of the Office of the Secretary of Defense, the Organization of the Joint Chiefs of Staff, the Unified and Specified Commands, the Defense Agencies and the Military Departments. This organization emphasizes audits of multi-Service programs and systemic programs with general application throughout the Department. The Assistant Inspector General for Auditing is also responsible for the central coordination of all internal audits by DoD internal audit agencies and GAO in order to assure adequate coverage of DoD programs and to avoid duplication of effort.

Audit Followup

The Assistant Inspector General for Audit Followup ensures prompt resolution and corrective action on all internal audits and provides oversight of resolution and disposition of contract audits. This office performs followup on all audit reports issued by the Defense Inspector General and the General Accounting Office and monitors followup on audit reports issued by the Military Service audit agencies. Our followup system is currently tracking over 2,100 internal audit reports with over 7,600 recommendations. It also tracks action on over 10,000 open contract audit reports.

Audit Policy and Oversight

The Assistant Inspector General for Audit Policy and Oversight establishes DoD audit policy and oversees the implementation of contract and internal audit policy within the Department. He also evaluates the performance of all audit and internal review organizations within the Department.

Criminal Investigations Policy and Oversight

The Assistant Inspector General for Criminal Investigations Policy and Oversight establishes Departmental criminal investigative policy and oversees the performance of all criminal investigative agencies within DoD.

Investigations

The Assistant Inspector General for Investigations investigates criminal violations including major procurement and contract fraud, corruption, bribery, and major thefts. The Defense Hotline also falls under the operational control of the Assistant Inspector General for Investigations.

Inspections

The Assistant Inspector General for Inspections evaluates efficiency and regulatory compliance within the Defense Agencies such as the Defense Logistics Agency, DoD Dependent Schools, and Defense Investigative Service. He also conducts special inquiries of waste, mismanagement or other improper conduct when an audit or a criminal investigation is not warranted.

HOW THE IG HANDLES INVESTIGATIVE RESPONSIBILITIES IN THE DEPARTMENT OF DEFENSE

The Inspector General's responsibility regarding DoD criminal investigations is threefold: He conducts criminal investigations directly through the Assistant Inspector General for Investigations, who heads the Defense Criminal Investigative Service (DCIS). He also provides criminal investigative policy to all DoD criminal investigative organizations. Finally he oversees all criminal investigations, including those conducted by the Army, Navy and Air Force.

When the IG was established, Congress decided to leave the military criminal investigative organizations--the Army Criminal Investigation Command, Naval Investigative Service and the Air Force Office of Special Investigations--in their respective Military Departments. Currently in DoD there are 6,406 people assigned to the DoD criminal investigative organizations, of which 3,787 are criminal investigators. Of the 3,787 criminal investigators, 232 are assigned directly to the IG, DoD.

The Inspector General Act permits the IG to request the military criminal investigative organizations to conduct investigations into allegations of particular interest to him. I have made numerous such requests to the Army, Navy and Air

Force. Its important here however, that I point out that, in addition to contract fraud, the military investigative organizations are responsible for investigating a broad range of other serious crimes including narcotics violations, thefts, arson, vandalism, murders, rapes, assaults and other crimes of violence which occur on military bases. Furthermore, the Navy and Air Force criminal investigative agencies have significant responsibilities regarding foreign counterintelligence.

We estimate that there are 777 fraud designated criminal investigators in DoD at present. We have recommended adding 400 more over the next three years. These figures compare to only about 425 fraud designated criminal investigators in 1982.

I believe my relationship with the military criminal investigative organizations is a productive one. My office, through its oversight role, provides advice and guidance in investigative techniques, and assists these organizations with training and implementation of new investigative techniques. We also provide leadership and coordination for Department-wide investigative efforts. My office also serves as the primary DoD contact between the Defense criminal investigative organizations and the investigative offices of the Department of Justice, including the Defense Procurement Fraud Unit.

When I became the Inspector General, there was virtually no DoD-wide policy for conducting criminal investigations. In the past three years, we have concentrated our efforts in developing policies in the following new areas:

- Investigative and prosecutive jurisdiction between DoD and DOJ.
- Investigative responsibilities among DoD criminal investigative organizations.
- Issuance of IG subpoenas.
- Use of search warrants.
- Coordination of remedies in fraud cases.
- Access to records.
- Investigative report format.

- o Criminal investigative analysis (trend and vulnerability analysis).

- o Developing a management information system to track DoD criminal investigations.

In addition, we have conducted a number of oversight projects designed to identify areas where improvements may be required. These include projects dealing with:

- o Suspension and Debarment actions.

- o Proactive operations by DoD criminal investigative organizations.

- o Adequacy of fraud agent strengths.

My office has placed great significance on enhancing the ability of DoD investigators to deal with allegations of fraud. We have conducted 18 five-day contract fraud training seminars which have provided advanced contract fraud training to over 600 criminal investigators.

I also believe that it is essential for procurement personnel to be sensitive to fraud schemes by Government contractors. Historically, the majority of contract fraud cases are discovered by contracting officials. Therefore, these officials must be aware of contract fraud indicators and of their responsibility to report suspected fraudulent activity to auditors and investigators. In this regard we have prepared a handbook on contract fraud indicators which has been distributed to 50,000 DoD procurement, audit, and investigative personnel. My office has also conducted over 400 fraud training sessions for 20,000 procurement personnel. This is in addition to 6,400 fraud training sessions which were provided to 240,000 DoD management officials by criminal investigators assigned to the Military Departments.

My office has also issued 15 Fraud Awareness Letters to DoD personnel highlighting specific fraudulent schemes affecting DoD procurement. These Letters are designed to alert procurement personnel and to encourage reporting possible violations of law, such as cost mischarging, delivery of shoddy materials, bribery and kickbacks, travel fraud, medical fraud, and computer related fraud.

Our commitment to the improvement of fraud awareness has moved outside of DoD. We have developed training materials to be used by trade associations and contractors to help their members and employees recognize the types of procurement fraud investigated and prosecuted by the Government. These training materials are appropriate to all levels of suppliers, including prime contractors and various levels of subcontractors. Hopefully it will be used in their self policing activities and in the oversight of subcontractors and suppliers.

Suspensions and Debarments

In addition to these efforts, my office completed a review of Suspension and Debarment Authorities within DoD. Under the Federal Acquisition Regulations, the DoD has the right to protect itself from contractors who cannot adequately demonstrate their responsibility as Government contractors. The regulations relating to suspension and debarment are designed to enable the Government to protect itself from such contractors by barring them from doing business with the Federal Government. My office was concerned that DoD was not taking adequate suspension and debarment action in contract fraud cases because of a lack of coordination between criminal investigators and procurement officials. Our report, which was fully endorsed by Department officials, identified numerous weaknesses in the system. As a result of our report and related Department actions, the Department now has an effective procurement remedy in this area. For example, in 1984, DoD suspended or debarred 454 contractors compared with 79 in 1980. In addition, through the end of August, 1985 DoD has taken 408 suspension and debarment actions.

Inspector General Subpoenas

The Inspector General Act recognized that, in performance of the duties assigned by the Act, Inspectors General would encounter situations where they would need access to various types of documents in the possession of non-Government entities. To meet this need, the Act authorized Inspectors General to require by subpoena the production of any documents or information necessary in the performance of functions assigned by the Act.

Since September 1983, I have issued 160 subpoenas in various matters in the discharge of my responsibilities under

the Act. For the most part, the subpoenas were related to inquiries in the areas of procurement, bribery of Government employees, and conflicts of interest. A number of the subpoenas were issued to financial institutions to obtain customer transaction and account data. In such cases, we scrupulously complied with the requirements and procedures of the Right to Financial Privacy Act. To date, we have had four instances in which we found it necessary to seek enforcement of a subpoena by seeking the order of a United States District Court. The enforcement order has been granted in all four instances, including the recent decision involving access to internal audit reports of Westinghouse.

With respect to the investigation of criminal offenses, particularly procurement fraud matters, my office, over the past two years, has developed two key documents which identify investigative jurisdiction.

One of these documents is the 1984 Memorandum of Understanding between the Department of Defense and the Department of Justice. This document prescribes basic guidelines to clarify the respective investigative responsibilities of the Federal Bureau of Investigation and the Department of Defense criminal investigative organizations.

The second key document, a Department of Defense Instruction entitled "Criminal Investigations of Fraud Offenses," governs fraud investigative responsibilities among the four Department of Defense criminal investigative organizations. By the terms of this Instruction, I have delegated responsibilities for investigating various allegations of fraud to each of the military criminal investigative organizations.

During the period 1982 to 1984, we have seen an increase in the number of fraud investigations conducted. In FY 1982, 1,801 fraud investigations were completed as compared to 2,311 in FY 1984. This increase is particularly significant in light of the fact that the Military Service criminal investigative organizations are moving away from involvement in the simple, low dollar fraud investigations to a greater participation in the more time consuming and complex procurement fraudinvestigations.

From 1982 through 1984, the number of Department of Justice convictions in all types of cases resulting from our

investigations has also increased. In FY 1982, there were 102 Department of Justice convictions while in FY 1984 there were 181. In the first half of FY 1985, we have reported 156 Department of Justice convictions.

Within the past year, these convictions have begun to include some of the larger DoD contractors - GTE, Sperry, General Electric, and National Semiconductor. Others, like General Dynamics, remain under active investigation as part of an inventory of investigations that has seen many of the top 100 DoD contractors added to it in the past two years.

RELATIONSHIP WITH DEPARTMENT OF JUSTICE

As you are aware, in 1982, the Secretary of Defense and the Attorney General agreed that DoD procurement fraud was such a priority that a special Defense Procurement Fraud Unit was established. I supported this agreement and was personally involved in several meetings which led to the actual creation of the Unit. The Unit is manned by Department of Justice and Department of Defense lawyers and investigators, and receives support from the Defense Contract Audit Agency as required. We believe the Unit serves several very positive purposes and is a definite asset in our mutual efforts to enhance the detection and prosecution of fraud. I believe the advantages of the Unit can be summarized in two categories.

First, I have directed that the Unit be notified of all procurement fraud allegations at an early stage of the investigation. While this results in notifying the Unit of a large number of matters which may not have eventual merit for criminal prosecution, early notification has the following major benefits:

o Identification of highly significant allegations which demand investigative priority.

o Identification of matters that do not require extensive investigation and which can be disposed of through existing contractual or administrative remedies.

o Early involvement of the Department of Justice Civil Division to ensure appropriate civil fraud action.

Secondly, the Unit serves as a catalyst in energizing many United States Attorney's Offices to become more involved

in Defense-related cases. Through the Unit, we have been able to communicate, and obtain agreement on, our investigative priorities. I would characterize our four highest priorities as follows:

- o Product Substitution Cases
- o Cost Mischarging/Defective Pricing Cases
- o Corruption/Kickback Cases
- o Theft

Within the last several years, many large United States Attorneys Offices have clearly shown their interest in pursuing DoD cases, and I attribute this interest to the priorities established by the Department of Justice and to the ongoing communication and education provided by the Defense Procurement Fraud Unit. The involvement of the 94 United States Attorneys, is absolutely essential in light of the relatively small number of cases to which Unit resources can be dedicated. By screening quality investigations, making timely referrals to United States Attorneys and by assisting in the specialized fraud training of the Assistant United States Attorneys in the field, the Unit is capable of maximizing the Department of Justice effort in the procurement fraud area.

My efforts to track the Department of Justice criminal and civil actions take several forms. First of all, on a general basis, I have stressed the need for prosecutive attention to DoD cases by writing to each of the individual United States Attorneys. In addition, I have made personal appearances before the Department of Justice Economic Crime Council, which is comprised of approximately twenty United States Attorneys, to make a similar request. I have also visited many key United States Attorney's Offices to discuss significant DoD investigations.

Beyond these general efforts, my office is constantly involved in an ongoing informal dialogue with many Assistant United States Attorneys regarding the progress of our cases. This dialogue, which normally involves members of my staff who are assigned to the Office of the Assistant Inspector General for Investigations or the Office of the Assistant Inspector General for Criminal Investigations Policy and Oversight, not

only focuses on the status of criminal prosecutions, but also on coordination of criminal remedies with administrative or contractual remedies.

Our oversight of cases referred to the Department of Justice also includes a review, currently underway, to determine if any significant investigations involving our top 100 contractors are being delayed as a result of inadequate audit or investigative resources, or lack of prosecutor attention. If the latter is determined, the Department of Justice Criminal Division stands ready to intercede.

Finally, there are occasions when my office has elected to write to various Department of Justice officials concerning the status of certain cases. Two such examples, one involving 26 cases and the other involving the General Electric case in Philadelphia, PA, reflect our specific interests in the progress of those matters. As you are aware, the General Electric case has resulted in criminal indictments and guilty pleas.

In conclusion, I cannot say I am completely satisfied with the collective efforts of DoD and the Department of Justice in the procurement fraud area. Yet, given the limited commitment of the two Departments in this area only two or three years ago, our progress since then has been clear and positive. I firmly believe more improvements and more resources are required. Specifically, I believe the following initiatives must be undertaken or continued if further progress is to assured:

- o More audits by the Defense Contract Audit Agency in the incurred cost area where fraud is most likely. The Defense Contract Audit Agency is already making process in this area.

- o Improved fraud training for auditors.

- o Advanced fraud training for investigators.

- o Increased number of fraud investigators consistent with my recommendations issued earlier this year.

- o More specialized Defense procurement fraud

training for the Department of Justice prosecutors involved in DoD fraud cases.

- Significantly more Department of Justice prosecutors assigned to either the Unit or the fraud Divisions of the United States Attorneys Offices. Expanded use of Military Attorneys should be tried.

With these initiatives and the current resolve of the two Departments, I have no doubt that we can realistically seek our objective of creating tremendous disincentives to fraud. Only if these disincentives can be achieved through increased levels of criminal, civil and administrative penalties can there be any legitimate expectation that fraud can be prevented. I look forward to working with the Department of Justice and the Congress in those prevention efforts.

This concludes my prepared remarks and I would be happy to answer any questions by Members of the Subcommittee.

Senator GRASSLEY. Our next witness is Victoria Toensing, Deputy Assistant Attorney General for the Criminal Division. With her is Mr. Morris Silverstein, Chief of the Defense Procurement Fraud Unit.

I thank you both for coming today, and I will indicate to you, as I did to the others, that we would ask you to summarize your statement in 7 minutes, and your full statement will be inserted in the record.

I would ask that you stand, so that I could swear you in.

Do you swear to tell the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. TOENSING. I do, Senator.

Mr. SILVERSTEIN. I do.

TESTIMONY OF MS. VICTORIA TOENSING, DEPUTY ATTORNEY GENERAL FOR THE CRIMINAL DIVISION, ACCOMPANIED BY MORRIS SILVERSTEIN, CHIEF, DEFENSE PROCUREMENT FRAUD UNIT, DEPARTMENT OF JUSTICE

Ms. TOENSING. Mr. Chairman, I welcome the invitation to speak to you today about what the Department is doing to combat fraud in the defense procurement process.

I feel confident that if the public understands not only the great efforts we are putting into this fight——

Senator GRASSLEY. Ms. Toensing, we are interested in your total presentation, but I believe that it is not difficult to understand that the thrust of our concern is: Why are so many defense contractors getting off scot-free, why are there not more individual prosecutions, and why there are so many plea bargains; we are running out of time, since both parties of the Senate, on Tuesdays, do have their caucus meetings on Tuesdays.

Ms. TOENSING. I understand that, Senator, but I know that this is an important area, and I am willing to cancel my appointments. I think it is important that you understand how this works, because it does none of us a service to have false statements out in the public arena. Then we are so busy back-pedaling with these inaccurate statements and misunderstandings of the process, we do not have time to get about our business. So, if you could just spare a few minutes with me, while I explain how the process works, maybe that will help you pinpoint some of your questions later.

Senator GRASSLEY. So you are going to use your 7 minutes, then, to show us how the process works; is that it?

Ms. TOENSING. That is what I understand you wanted, Mr. Chairman, and I want to give that to you so that you can understand some of this.

Senator GRASSLEY. I think what I will do, Senator Metzenbaum, is—we have our questions we want to ask, we will let her use her 7 minutes, and then we'll proceed with our questions.

Proceed.

Ms. TOENSING. Thank you, for giving me this opportunity, because I think that we should clearup some of the inaccuracies out in the public record.

First, I want to say that our policy is to prosecute both Defense contractors and corporate employees whenever we have evidence of

fraud sufficient for convictions. There will be a few times, I am sorry to say, that we will not be able to prosecute individuals, and will be able only to go against the corporations.

Out of our 36 indictments, there were two cases in which only the corporation was proceeded against. I do not like that situation, but if we have a choice of only going after the corporation or going after no one at all, we will go after the corporation.

I might add that sometimes the facts just lend themselves to that, where it is the only fair thing to do; but we hate it, when we see that kind of situation.

To understand today, Mr. Chairman, we have to go back to the yesterdays of prosecuting defense contract fraud, because we have come a long way.

Three years ago, extensive and time-consuming internal Department of Defense procedures slowed down referral of contract fraud allegations from DOD to DOJ. There was little coordination between DOD investigators and DOJ prosecutors.

Most U.S. Attorneys, of all administrations, dislike these cases, because they are complex; experienced prosecutors perceive them as taking many personnel hours, and lacking in jury appeal. But even if, after all of the work, the jury understood the voluminous documents and convicted, judges rarely gave sentences more than probation. This latter problem, as you know, is not within our control. And, I am sorry to say that there has been little improvement.

As one judge said last year, after a protracted trial that ended in convictions but a dismal sentence. "It is only money." This is very frustrating to us, and we share your concern about this, because when we convict somebody and it is all out there for the judge to give a hearty sentence, so we are as frustrated as any of you are that there are no prison sentences given.

What we also found, in looking at our problems of yesterday, is that there were terrific DOJ attorneys who could put together a paper-trail fraud case, but who knew nothing about defense auditing or defense contracting; and, likewise, DOD had people who knew all about defense auditing and contracting, but who knew little about putting together a trial.

We put them all together, literally, under one roof, the Army, the Navy, the Air Force, DOJ attorneys and DOD and FBI investigators, all working together in a particular expertise.

I might just correct the record. There are not four attorneys, there are 10 full-time attorneys in the unit, and there are also several part-time attorneys from certain divisions within the Justice Department; we have two part-time attorneys, antitrust attorneys, and two part-time Civil Division attorneys.

Then we also have a backup—and, Mr. Chairman, I would like to point this out to you because you said something about the unit did not prosecute something but that the "fraud" attorneys did. Well, that is how we have the project set up, so that whenever we need extra personnel, we can go right to the fraud section and pull out people to work on cases. We see that as an advantage, and how it should be worked so that when there is a priority, we can grab the extra attorneys to work inside the unit. We do not see that as a downside.

Now, let me explain——

Senator GRASSLEY. We were asking for statistics just on the Defense Procurement Fraud Unit, and then when we asked for those statistics, there were statistics brought in from the Fraud Unit generally.

Ms. TOENSING. Let me clear that up, because these are unit cases, but what happens is, when we need more personnel because of the workload, then we just ask fraud section attorneys to supplement those attorneys in the unit. And we do that so that, when there is not a whole lot of procurement prosecution work going on, those fraud attorneys can then go back to the fraud section and work on other types of fraud cases. We think that that is sufficient, and that is how we have organized it.

Let me explain to you, though, how this unit works. I think this is important, because it is not like other kinds of cases that we are all familiar with. We are not going after these cases in the same old way. In most Federal cases, prosecutors see them for the first time after they have been thoroughly investigated. We revised our thinking here and decided that we needed a centralized preliminary screening to separate the wheat from the chaff early on, so that the investigative efforts could be directed at cases with criminal potential.

Let me turn to these two charts. You have the same charts in front of you, but sometimes it is easier also to look at the larger charts.

The higher one illustrates our old way of doing these cases, and the lower one illustrates the new way. There are two basic types of cases we get in defense procurement fraud: accounting and nonaccounting. And you see those in the rectangles at the top of these charts.

Before we had the unit, the matters went from these DOD components at the top to DOD or the FBI investigative units, and then straight to the U.S. attorney's office. That was it. And many times what they did was merely languish there, because of the perception problem that we had with the U.S. attorneys. There was no procedural mechanism to focus special attention on these cases.

Now, the way that we have reorganized it. The accounting cases, the unit receives audit reports at the same time that these reports are forwarded to the DOD investigative agencies.

The nonaccounting allegations go to the DOD investigative agencies and to the FBI. They, in turn, send what is called significant matters directly to the unit.

Now the screening process takes place. That is what is important, that we now have a mechanism for looking at these cases early on. We are going to get some things that just have no criminal prosecution worthiness. But we wanted to be able to get these things early on, so we could make those decisions, and did not miss potential criminal cases.

We have four options there, and the rectangle near the bottom explains those. We can either take the case as a criminal case, we can take it as a civil case, send it off to the civil division attorneys, we can send them to the U.S. attorney. And we like to do that as much as possible, because of just the reason that Inspector General Sherick mentioned, that it is much better if we can keep them in the U.S. attorney's offices. We can return them for more work, if

they need more work, or we can decline. Those are the 4 options we have when they get to the unit.

The rationale is twofold: We want to involve prosecutors at the very early stage of the investigation, and we want to focus special attention on significant cases. So, one function of the unit is to screen; a second function, then, is to prosecute a portion of these nationally significant cases. And we focus our attention in the unit on the complex-accounting, fraud cases. These take considerable resources and time to develop.

So, many of the cases that are presently under investigation, and have been for some time, will not reach indictment for some time in the future.

I can guarantee you you will be seeing some of these in the next few months. We have made considerable progress in the last 18 months. We have prosecuted three important mischarging cases, including *United States* v. *Systems Architect, Inc.,* which you discussed earlier. That is a landmark conviction, because it is the first time that such a case was brought to trial in which high corporate officials were indicted.

However, the president of SAI, the only one sentenced to prison, received a 1-year sentence with all but 30 days suspended. Now, that is not our fault, and we are very upset about that.

Senator METZENBAUM. Did the U.S. attorney speak up to the court and indicate that there was opposition?

Mr. SILVERSTEIN. Yes, Your Honor, the prosecution made an affirmative recommendation for incarceration at that time.

Senator METZENBAUM. Thank you.

Ms. TOENSING. Another example——

Senator METZENBAUM. But I am not Your Honor.

Mr. SILVERSTEIN. Excuse me.

Ms. TOENSING. He thought he was back making the argument. He was ready to do it again.

Another example of mischarging is the *GE* case. The Philadelphia U.S. attorney's office convicted GE of 106 counts of false claims and false statements, and, Senator Metzenbaum, I would like to clear this up with you, because I would like for you to clear up the record. There were four individuals indicted in that case, and there was no plea bargaining. GE pled to the indictment. That is no plea bargain, that is getting your guilty plea on everything that occurred.

Senator METZENBAUM. What happened to the four individuals?

Ms. TOENSING. Let me see. One was convicted.

Mr. SILVERSTEIN. One pled guilty, one was convicted, and two are awaiting trial.

Senator METZENBAUM. And the company, you tried the company or the company pled guilty? I did not get that.

Ms. TOENSING. They pleaded guilty to the indictment.

Senator METZENBAUM. With a plea bargain arrangement?

Ms. TOENSING. No.

Senator METZENBAUM. And what did the court do to them?

Ms. TOENSING. Have they been sentenced?

Mr. SILVERSTEIN. I believe they were sentenced to the maximum fine.

Ms. TOENSING. But you do not send corporations to jail. When you indict a corporation, that is what you get.

Senator METZENBAUM. How much was the maximum fine?

Mr. SILVERSTEIN. I believe it would be $10,000 per count, so that would be $1,060,000.

Senator METZENBAUM. Do you think that we ought to change the law to increase that either ten or a hundredfold? Because even $100,000 is no money to a corporation today.

Mr. SILVERSTEIN. I believe the Comprehensive Crime Control Act of last year enhanced penalties to $250,000 and $500,000. I believe one of the problems in the *General Electric* case was that the effective dates of the Comprehensive Crime Control Act postdated GE's underlying conduct.

Ms. TOENSING. And the only way I want to mention GTE around here is just to put on the record, because I know you had made the statement before, Senator Metzenbaum, that no individuals were indicted in the *GTE* case, and there were, in fact, three.

Senator METZENBAUM. I was wrong in that. I was wrong. That is what I said in a statement several weeks ago, I think, but then that was brought to my attention. I did not say that today. At least I did not think I did.

Ms. TOENSING. Let us just say that now we all know.

You have been provided the sheet by the Justice Department of all of these cases. Let me just summarize for you.

During the past 3 years, the unit and the fraud section have had 34 indictments or informations filed against 36 individuals and 10 corporations. In only 2 cases were no individuals charged. Thirty-one individuals have been convicted; 4 are not yet tried; 1 was acquitted.

Of the 24 individuals who have been sentenced, judges gave only 9 prison terms.

Senator METZENBAUM. Were any of those against a major contractor? I know GE, GTE, those are major contractors; but of the 36 that you mentioned, how many were major contractors?

Ms. TOENSING. We would have to go through the list for you and get them.

Senator METZENBAUM. Of the top 100. Well, the list that I have seen, prepared by staff——

Ms. TOENSING. The GTE, GE, Sperry—what is Industrial Tech?

Mr. SILVERSTEIN. Senator, by major contractors, I assume you are talking about the top 100 contractors. For example, in the *Davey Compressor* case, $1.7 million was the amount that the Government was defrauded and there was $3 million in fines and so on.

I think the fact that a contractor is not in the top 100 does not mean that the amount of fraud involved is not major and not significant.

Ms. TOENSING. You see, a top 100 contractor can have a lot of money with a Government contract, but not have done anything fraudulent, and you might have lots of fraud in a smaller one.

Senator METZENBAUM. I see. But the fact is that of the 36, there were only 2, or at best 3; and the facts are that every day we read new stories about different defense contractors being involved in this, that, or some other kind of impropriety.

Ms. TOENSING. Yes. I have those figures, though, for you here. We have major contractors under investigation at this time, as the inspector general has also shared with you. I think you are all aware of those figures. We have investigations of 23 of the top defense contractors.

Now, our figures will differ from the inspector general's, because he has them in a different stage, and we would not have received all of his investigations yet.

But what is important and what you have to understand is that up until 3 years ago no Department of Justice had ever kept figures of Defense procurement fraud. You had no interest in it before the last few years. As Mr. Sherick said, he had to go out and get the troops interested in this whole subject matter.

I want to make clear, too, that all of these cases that we talk about will not result in an indictment. The nature of these investigations is such that many times there are mistakes, there is negligence, there is good faith, differing interpretations of contract provisions.

Speaking of policy, I would just like to——

Senator GRASSLEY. Would you be able to sum up in just a minute?

Ms. TOENSING. Yes. I would like to take 1 minute to push our antifraud initiative. And if I spare you going into that any longer, would you look at it more carefully?

Senator GRASSLEY. Proceed.

Ms. TOENSING. Let me point out one thing in conclusion, Mr. Chairman. There are limits to what the criminal justice system can do. Criminal prosecutions provide one important weapon for ensuring integrity in the procurement process. But a criminal prosecution can only be used where we have fraudulent intent or corruption can be proved beyond a reasonable doubt.

In the majority of cases of procurement waste or abuse, fraud either is not present or it cannot be proven. Many of the problems involving defense contractors do not involve issues of fraud. For example, purchasing equipment not needed or used—situations such as that.

In these instances, integrity in the procurement system must be achieved through other tools: Effective contract procedures, internal controls, and vigorous use of other methods, such as suspension and debarment.

But it is also important that the public understands that there will be situations where constitutional rights will prevent prosecutions that include all guilty persons.

For example, when an auditor finds something wrong with the books of a corporation, and the only information we have is that which is on paper. That is what these cases are all about. There are two sets of books, for instance. We cannot haul that bookkeeper into the grand jury and force him or her to tell us why there are two sets of figures. The fifth amendment protects each of us against self-incrimination.

So it usually turns out that the bookkeeper's attorney comes in and says, "You give immunity and the bookkeeper will tell you" what he or she knows.

That is how these cases, these paper-trail cases, are worked. These are not bank robberies, they are not crimes of violence, where the very fact of committing the criminal act usually assumes the requisite intent or knowledge for prosecution. Those kinds of cases are much easier to prosecute.

We have made a choice in this society of freedom and protection from excessive governmental intrusion that it is better to have the Bill of Rights than to get all those guilty of committing crimes. And that is the balance we have struck. I am not ready to change that. I am sure this committee is not ready to change that.

Therefore, we commit ourselves to pursue vigorously these offenders, and also to do so without violating the laws of the Constitution.

Senator GRASSLEY. Thank you, Ms. Toensing.

The time that the Fraud Unit devotes to screening, as opposed to prosecuting, has brought about criticism. We have developed that over a long period of time. For example, the Defense Criminal Investigation Service agents have indicated that screening serves more to bog down cases than to expedite those cases with the best potential for successful prosecution.

What does screening just about all the Department of Defense procurement fraud cases have to do with the original charter of the Fraud Unit, which was to conduct nationally significant investigations and prosecutions?

Ms. TOENSING. But that is how we find them and that is how we get them on the right track, because unless we look at these cases early on and decide that one has merit and another one should really be going through the system, then we are really just spinning our wheels, as we were in the old days, when the cases went just to the U.S. attorney's offices. We have to put them on some kind of a track.

Senator GRASSLEY. OK. I have here an example of how the Unit screens cases and makes suggestions to investigators. Here is a conversation record. It says here, quote, "determine dollars lost; when case is sufficiently developed, take to the local assistant U.S. attorney," only if it is spelled out, AUSA, "for prosecution."

Now, is this not basic and obvious direction the investigators would know without the benefit——

Ms. TOENSING. I apologize. I did not understand what you said. I do not have the picture of what you mean.

Senator GRASSLEY. OK. Then I will go into some more detail. We have here what is referred to as a conversation record, and it would be my——

Ms. TOENSING. Between?

Senator GRASSLEY. OK. It is between Silverstein and the Defense Procurement Fraud Unit, and the DCIS, and this is what it says, "determine dollar lost; when case is sufficiently developed, take to local assistant U.S. attorney for prosecution."

Ms. TOENSING. Well, since this involves Mr. Silverstein, let me have him answer it.

Senator GRASSLEY. OK.

My question is this: Is this not basic and obvious direction investigators would know without the benefit of your unit's advice?

Mr. SILVERSTEIN. Senator, that depends. It depends, one, are there other investigations involving this same company? Two, is this a U.S. attorney's office that is heavily involved in prosecuting these cases? Three, I can tell you from experience it is not always that basic and obvious. There are certain aspects when you look at, for example, an audit report, that have to be developed.

There may be a loss to the Government, but the loss to the Government may not involve an area of the audit report that suggests criminal or fraudulent activity. There may not be a loss to the Government.

It is pretty difficult taking a case into court where there is no loss to the Government and trying to tell the jury and the judge that the Government has been deceived. What is the reason for the deception? What is the motivation? That is a basic fact.

I do not think that bogs down the process at all. I think that conversation——

Senator GRASSLEY. How long does it take to screen cases?

Mr. SILVERSTEIN. It depends. In some situations in which we have screened cases, we have had meetings with auditors and investigators and it has taken us 2 days. A lot of cases may just take a half hour, 45 minutes, or sometimes, depending on if it is a very simple fact situation, it will take less time than that. It varies in each case. We have spent 2 days reviewing one particular case. We have had situations where we have had the auditors and investigators come back several weeks later and several weeks later, we need more information. What do the Government's own records show?

Senator, you have to understand about these cases, that the nature of the conduct, what occurred is that the Government is told A and the auditors will say, or the inspectors will say, B occurred.

Now, the first thing we have to find out—is the Government correct? The second thing we have to find out, was this action done with intent to defraud? That means, was it done by mistake, was it done with inadvertence, or was it done by negligence? A company may have a certain group of officials who are dealing with the Government and telling the Government that this is our pricing proposal, and it is going to cost us $900,000 to purchase the metal from the supplier. Meanwhile, you have the estimators, who are over here on the other side of the shop, who do not talk to these people who are negotiating. And these people are suddenly able to get a better deal, and it is only $800,000 that it is going to cost the Government.

What we have to find out is: Did anybody in that corporation who told the Government $900,000, or who is aware the Government was being told $900,000, aware of the true facts?

Let me give you an example, Senator, of the type of thing screening does, and what we are talking about in these cases.

Senator GRASSLEY. Well, I will be glad to listen to that, but do you not think, though, that investigators ask those questions themselves?

Mr. SILVERSTEIN. Investigators often ask those questions themselves; often they do not. That is my experience. And I would rather spend that half-hour up front, making sure that those ques-

tions are asked, rather than have an investigator go out and spend a lot of time on the case, when a key question has not been asked.

And I have seen that on several occasions, that the key question, Is the Government out any money?, has not been asked. And, if asked up front, then we could have——

Senator METZENBAUM. Mr. Sherick points out that you are dealing in an area where sometimes it is not money, but it is loss of life. The armorplate is not strong enough, the parachute cords are not strong enough.

Ms. TOENSING. That is why defective products are one of our priorities, and Mr. Sherick's priorities.

Senator METZENBAUM. OK.

Mr. SILVERSTEIN. The majority of our cases are in the accounting fraud area. We have as a priority the defective products cases. But these cases, more so than the accounting fraud cases, can be handled by U.S. attorneys. And we tell the investigators to take them out to the U.S. attorneys right away, and we——

Senator METZENBAUM. Let me ask you both, why do you think that the public has gained the perception that defense contractors are not fully prosecuted under the law and that they have some special kind of protection; do you think it just happened? You are here saying to us:

> We are really doing a great job, we are doing this through the Defense Procurement Fraud Unit, and just kind of look at the statistics, look at this.

And yet the average American feels that the Defense contractor stands protected, and that his Government is not willing to fully prosecute those who are transgressors to the full extent of the law. Why do you think that is?

Ms. TOENSING. Senator, I would like your help in that, because when you go——

Senator GRASSLEY. Would you also comment on Sherick saying that we are outmatched. I think it works right in with what he is asking about here.

Ms. TOENSING. Well, which one?

Senator GRASSLEY. Be our guest.

Senator METZENBAUM. Well, answer his question, and then answer mine.

Ms. TOENSING. Senator, I will be glad to supply you with the facts on cases, because it really is a problem for us. We have had to back-pedal on *GE* and *GTE*, when you went on national television and said that in both cases we had not indicted any individuals. And then the press picks that up, and they repeat that, because they hear you say it.

I see articles now that are repeating that kind of accusation, and it is very frustrating to us, because, on cases where we are doing what—your statements do not have the correct facts——

Senator METZENBAUM. You think my one appearance on national television is enough to create a whole—perpetuates it?

Ms. TOENSING. It perpetuated it. I see you quoted, and it says, "Senator Metzenbaum wants hearings because the Department of Justice has not indicted anybody in *GE* and *GTE*."

That is so frustrating for us. We would really appreciate all of us working together on this. As Joe Sherick said:

There should not be tension here, there are things that each of us can do, and we should be looking at these problems, and working toward finding a solution together.

I would like the Senate to start by undoing the House Joint Resolution that the Senate passed in the crime bill last year, and I will have the number for you in a minute, HJR 648; that indicates that nonviolent criminals should not be sentenced to prison. I will be glad to go over this resolution with your staff. I would really like to see that undone, because that is a problem. Here we have this in the Congressional Record, we have a statement that says, "Nonviolent criminals should not go to jail." That is frustrating for us. We would like to take something into court——

Senator METZENBAUM. Who said that? Who said that?

Senator GRASSLEY. I think that the perception out there comes, because we do not see very many of the big Defense contractors actually prosecuted. Now, we have only had two cases involving the top 100 contractors, Sperry and GTE—or three with GE. Right?

Ms. TOENSING. Mr. Chairman, we have got to go where fraud is. When we get fraud cases on the big contractors, you do not find our people hesitating to go after them. But if you have got a lot of fraud in a small subcontractor, you better be taking those cases.

I am saying that that is not really the measure of whether we are out there getting fraud.

I mean, if there is no fraud there; some of the defense contractors are doing very well.

Senator METZENBAUM. A few years ago we had great scandals about ship contractors. I do not remember any particular individuals being prosecuted in those cases. We have had——

Ms. TOENSING. They were. They were. Unfortunately there was an acquittal.

Senator METZENBAUM. Wound up in an acquittal?

Ms. TOENSING. Litton. That was a corporation that was indicted, and there was an acquittal.

Senator METZENBAUM. OK, but not an individual?

Ms. TOENSING. Sometimes the facts do not give us that. Senator, we cannot go after them if we do not have the facts.

Senator METZENBAUM. Why did you not do anything in the Sperry case? How do you explain that to the Chairman?

Ms. TOENSING. Because that was an evidentiary problem, Senator, and there was a very big problem with that case. It seems like both sides looked at each other and assessed the risks. We came out with what we could get.

Senator METZENBAUM. But then you gave the exculpatory language that Mr. Silverstein was quoted on, that let them off the hook in some other part of the country. A global settlement.

Ms. TOENSING. That was not a global settlement case.

Senator METZENBAUM. But the Chairman read a letter which——

Ms. TOENSING. Sperry was. I am corrected. Sperry was.

Senator METZENBAUM. OK.

Mr. SILVERSTEIN. Senator, to answer the first question, why were individuals not charged in Sperry; there were a couple of key witnesses who presented a serious evidentiary problem so that we did not have a reasonable probability of prevailing on prosecution. That is our Department of Justice standard, that we have to be-

lieve that we are going to win the case before we prosecute any individual. OK.

Second, regarding the Sperry——

Senator METZENBAUM. Wait a minute, do not give me that. You blew two cases down in Alabama, those voting rights cases, you did not have a chance of winning those and you went ahead and prosecuted those poor blacks. So do not tell me that that is the only standard you use in the Justice Department.

Mr. SILVERSTEIN. Senator, I am talking about Morris Silverstein and the Procurement Fraud Unit and the cases that we prosecute. That is, I think, the subject matter of this hearing, and I would like to answer those questions.

Second, I did not handle the settlement of Sperry, that was a global settlement. That was before I came on board. But I was familiar with the facts of that case.

We do not favor global settlements at this time. There are a couple of cases that will result in global settlements, because they have already been in the process. What we try to do, right now, is to say that the Department of Justice is going to go ahead and, if we are going to prosecute, we let the contractor know that we are going to go ahead and do it. Then he takes his chances with the Department of Defense.

Senator GRASSLEY. Are you saying that there is a difference in the policy lately, as opposed to when these global settlements were reached, that will not lead to global settlements at this time?

Ms. TOENSING. We used to do global settlements, we now do not do global settlements.

Mr. SILVERSTEIN. Except for one or two situations, the Department of Justice will make its decision, and the contractor will go to the Department of Defense independently. Our decision is not hinged or related to the Department of Defense decision; we are going to go—if we decide we are going to go ahead, we are going to go ahead, regardless of what happens with the contractor and the Department of Defense.

Senator GRASSLEY. Was the GTE settlement a global settlement?

Mr. SILVERSTEIN. No, it was not.

Senator GRASSLEY. It was not?

Mr. SILVERSTEIN. No.

Senator GRASSLEY. Did you get any phone calls from the GTE general counsel, or DOD general counsel on those global settlements? GTE.

Mr. SILVERSTEIN. I received no phone calls. I know you are alluding to two phone calls that were made to an attorney in the unit, and to my superior. I am aware that those phone calls were made. I would say that——

Senator GRASSLEY. Do you know the purpose of those phone calls?

Mr. SILVERSTEIN. As far as I understand the purpose of the phone calls was to request the Justice Department to go ahead and continue its enforcement action, and if the Justice Department's enforcement action would not be hindered, there were certain requests made as to maybe holding off for a short period of time.

At no time—let me just say that the Department of Justice enforcement action was in no way affected. We moved ahead with the

GTE case at the earliest possible time that we could prosecute that case.

Senator GRASSLEY. Well, it had no effect, but was that a request to delay?

Mr. SILVERSTEIN. No, there was no request to delay, and, as far as I know, we never knew the reason for any—what has been reported in the papers, Senator, is, as far as I understand, completely erroneous, completely mistaken, completely misinformed

Senator GRASSLEY. When the Department of Justice is involved in negotiating a global settlement with a DOD contractor charged with criminal wrongdoing, should the Department of Justice prosecutors be lobbied not to proceed with suspension and disbarment of the contractor?

Ms. TOENSING. But we do not have them any more. We do not do global settlements any more.

Senator GRASSLEY. If you did global settlements, should that be——

Ms. TOENSING [laughing]. "If I beat my wife."

Senator GRASSLEY. Well, of course, you know, I am asking this because, based on an oversight hearing, this was done in the past.

Ms. TOENSING. And we do not like them, either. We do not like them, as does not Mr. Sherick, and so we quit doing them.

Senator GRASSLEY. As you know, the Sperry mischarging case was one of the first referred to the Fraud Unit in the fall of 1982. A year later, during plea negotiations with Sperry, Richard Sauber, then Chief of the Fraud Unit, recommended to the Department of Defense Debarment and Suspension Review Board that Sperry not be suspended from Government contracts.

I would like to enter in the record a copy of that letter, and I would like to ask you if you think that contractors can deal well enough with the DOD without our prosecutors going to bat for them?

Ms. TOENSING. You bet.

[Material submitted for the record follows:]

U.S. Department of Justice

Criminal Division

RAS:cld

Defense Procurement Fraud Unit
206 North Washington Street
Alexandria, Virginia 22314

September 27, 1983

Colonel Glenn R. Seeley
Chairman, Debarment & Suspension
Review Board
R-2B262
The Pentagon
Washington, D.C. 20330

Dear Colonel Seeley:

The United States Department of Justice has been conducting a criminal investigation of the Defense Systems Division (DSD) of Sperry Corporation for approximately one year. The investigation has focussed on the labor charging practices of a group of employees at DSD, which is located in Minneapolis, Minnesota.

In the beginning of August, the Department entered into plea negotiations with the company which have resulted in a proposed Plea Agreement, enclosed as Exhibit One. Essentially, Sperry proposes to plead guilty to willfull and intentional mischarging of labor costs, make full restitution, and take steps to ensure the further integrity of its labor accounting system. Prior to entering the Agreement, the company has inquired of the Air Force whether the company will be suspended or debarred as a result of the entry of the guilty pleas. In deciding on your recommendation, you have requested the Justice Department's views on this matter.

The facts of this case, as discovered within a federal grand jury, are such that a corporate guilty plea is the appropriate resolution of the matter. The individuals responsible within the company are middle to lower level employees who did not personally profit. There is a substantial question concerning government knowledge about the conduct at issue. For these and other reasons which were discovered during the investigation, the Department feels that the corporate guilty pleas coupled with full restitution to the Air Force represents a fair resolution of the case.

Not to be ignored is the deterrent effect of such a plea. The Department is serving notice on the defense industry that mischarging exists, that it exists in major companies, and that it is a criminal matter where the necessary elements of willfullness and knowledge are present. This plea will in no uncertain terms get the message across.

Finally, the Department recommends that the Air Force take no steps to suspend or debar based on the guilty plea. During the course of our investigation we became reasonably convinced that Sperry corporate management was genuinely upset about the breakdown in controls within certain sections of DSD. To respond to this breakdown in controls, management has undertaken a series

of changes and has proposed additional changes all of which are outlined in the company's report of August 31, 1983 submitted to you under separate cover. The Department has reviewed the Sperry proposals and feels that they address the problems exposed during our investigation. We feel that the submission is sufficient to justify a finding that Sperry is presently responsible to continue contracting with the United States Government.

I have discussed this matter at length with the Defense Contract Audit Agency and have provided them a copy of Sperry's August 31th submission. DCAA feels that the company is taking positive steps to correct prior inadequacies in its system that would prevent future labor mischarging. DCAA needs to ensure that the steps outlined by the company are in fact implemented and do in fact work, a position that we endorse. To that end, we have been assured by the company that DCAA will have access, on request, to all of the monthly reports prepared by Sperry's new Labor Charge Control Office and the quarterly reports prepared by the DSD Controller. (These reports are more fully described in the Sperry submission on pages 13-14.)

With these reports and through its normal audit procedures which includes interviewing employees regarding labor charging during the current and prior periods, DCAA will independently verify the effectiveness of the measures taken by Sperry. Should material problems arise between DCAA and the company over this agreement, we have instructed DCAA to notify us immediately.

Accordingly, we recommend that no suspension or debarment action be taken based on the guilty plea.

Sincerely,

Richard A. Sauber
Chief, Defense Procurement
Fraud Unit
Criminal Division

Senator GRASSLEY. We have already heard quite a bit today about the so-called DISC cases in Philadelphia, we have heard that the U.S. attorney there is capable of handling these cases without the Fraud Unit assistance. Is it not true that you and your predecessor, Mr. Sauber—and this is to you, Mr. Silverstein—were both requested by investigators to allow the Philadelphia U.S. attorney's office to handle the DISC cases in order to free up Fraud Unit resources for other cases, cases the U.S. attorneys could not and would not handle?

Mr. SILVERSTEIN. First of all, Senator, when you are—Mr. Chairman, when you are dealing with the DISC cases, what you are talking about so far is 23 convictions involving $220,000 in bribes. Those are cases that, in terms of significance and comparability, rank up with the major bribery scandals involving the Government that have occurred in the last decade.

The particular cases——

Senator GRASSLEY. What if the U.S. attorney handled them anyway?

Mr. SILVERSTEIN. OK. We are working with the U.S. attorney. The U.S. attorney is handling some of the cases; we are handling some of the others. The important thing to remember is that these cases involve four or five corporations throughout the country, so far, that have been prosecuted. And the information, the corporate knowledge in the head of one individual prosecutor in the Unit is a major reason why we have been able to successfully move these cases. We have asked the U.S. attorney's office, and the U.S. attorney's office is handling some of these cases.

Senator GRASSLEY. What about Sherick's charge that they are being used for statistical purposes?

Mr. SILVERSTEIN. I have to disagree with Mr. Sherick. I have yet to hear in the Department of Justice from any member of the unit or any superior to build up the unit's statistics. If we wanted to build up the unit's statistics, we could do a lot better then in pursuing the mischarging and accounting fraud cases that we are presently pursuing.

Senator GRASSLEY. Did you, in your answer to my last question, respond about why the Fraud Unit is still involved in the DISC cases?

Ms. TOENSING. Yes.

Mr. SILVERSTEIN. Yes, I did, sir.

Senator GRASSLEY. I want to say thank you for your testimony. That is all the questions I have.

I would like to make clear that at a later period, at an appropriate time, we will be getting testimony from Mr. Segal. That is very important for the record that we are trying to make.

Thank you very much.

Ms. TOENSING. Thank you.

[The prepared statement follows:]

Prepared Statement of Victoria Toensing

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss the efforts of the Department of Justice to combat fraud in the defense procurement process. Attorney General Meese has stated that great effort must be devoted to prosecution of complex white collar fraud cases, particularly in the defense procurement area. We believe we are making substantial progress. The Department's policy is to prosecute both defense contractors and corporate employees whenever we have evidence of fraud sufficient for conviction. We intend to devote all necessary resources to achieve that goal.

Three years ago, we initiated a concentrated effort in partnership with the Defense Department to uncover and prosecute criminal activity associated with defense procurement. The setting in which that effort began posed a number of problems. Extensive and time consuming internal Department of Defense procedures slowed the referral of contract fraud allegations. There was a lack of coordination between DOD investigators and DOJ prosecutors. It was difficult to develop contract fraud prosecutions in a timely fashion. Historically, U.S. Attorneys were reluctant to commit prosecutorial resources to defense procurement cases. Even experienced prosecutors perceived these cases to be very complex, time consuming and lacking in jury appeal. And even if the case resulted in conviction the court usually gave a sentence of probation. This latter problem is not under our control and I am sorry to say has not improved.

The Defense Procurement Fraud Unit was formed in the fall of 1982 as an integral part of the Criminal Division's Fraud Section to provide a solution to many of the problems. The Unit brings together Department of Justice prosecutors, Department of Defense attorneys, investigators and accounting staff to concentrate

solely on defense procurement fraud cases. The Unit has four major responsibilities. First, it screens potential significant defense procurement fraud cases. Second, it investigates and prosecutes a portion of the nationally significant procurement fraud cases. Third, its members provide advice and guidance to U.S. Attorneys' Offices and others. Finally, the Unit establishes and coordinates policy and enforcement priorities in the defense procurement fraud area.

A major responsibility of the Unit is to provide centralized preliminary screening of defense procurement fraud matters at a very early stage, far in advance of the point at which prosecutors usually become involved in cases. 1/ For example, the Defense Contract Audit Agency (DCAA), which audits DOD contracts, routinely sends to the Unit for screening reports of suspected cost mischarging and other suspected accounting frauds. Additionally, the Unit screens significant investigative matters not originating from DCAA such as defective products, false testing certifications, and bribery and corruption in the procurement process. The Unit also screens other DOD contract fraud matters that have an estimated loss in excess of $100,000.

When the Unit receives matters for screening, little if any investigation has been done. This is quite different from most referrals in non-DOD procurement fraud cases in which a significant amount of investigative work may have been completed before a prosecutor becomes involved. The Unit is staffed with experienced procurement fraud prosecutors, investigators and DOD contract lawyers. Therefore, they are able to suggest initial investigative steps that will focus on matters with criminal potential, thus separating these issues from those which are

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1/ Screening is the process by which a prosecutor conducts a preliminary evaluation for potential criminality to focus investigative resources on those areas with prosecutive potential.

strictly civil, contractual or accounting disputes. The screening process may reveal that mistake or inadvertence was involved in particular charges rather than fraud. This screening process avoids wasting investigative efforts on cases with minimum prosecutive interest and concentrates efforts on cases of potential criminality.

I have two charts which illustrate the changes in the process by which procurement fraud cases are referred for prosecution. Prior to the creation of the Unit both DCAA audit reports of suspected accounting fraud activity and DOD non-accounting allegations of possible criminal activity were referred to the DOD investigative agencies. Some of the DOD non-accounting matters were also referred to the FBI. 2/ After investigation, matters were then referred directly to the 94 U.S. Attorney's Offices, where they were either accepted or declined. Many times they merely languished. There was no procedural mechanism in place to focus special attention on these cases.

The second chart shows that we now have such a mechanism and how it works. The Unit receives DCAA audit reports of suspected accounting fraud at the same time that the reports are forwarded to the DOD investigative agencies. Non-accounting allegations continue to go to the DOD investigative agencies and the FBI. Both the DOD agencies and the FBI, however, refer potentially significant matters directly to the Unit for screening. At that point, the Unit may (1) accept the matter for criminal investigation and prosecution or for civil suit, (2) refer the matter to an appropriate U.S. Attorney's Office, (3) return the matter for more investigative work, or (4) decline prosecution.

2/ These include matters of defective products, false testing certifications, bribery and corruption.

This system enables us to accomplish two objectives: involve prosecutors at an earlier stage of an investigation and focus special attention on the significant procurement fraud cases to assure they will receive the resources needed to pursue them.

The Unit also investigates and prosecutes a portion of nationally significant procurement fraud cases. The significance and complexity of the cases worked actively by the Unit has increased substantially during the past year. The Unit has focused its principal effort on accounting fraud cases. Investigations of complex accounting frauds take considerable time and resources to develop to the point where decisions on prosecution can be made. Many of the Unit's cases, under investigation for some time, will reach fruition in the next several months. Others will not reach a decision point for some further period of time.

The Unit has already made a significant difference in the prosecution of defense procurement fraud cases. Comparison of today's enforcement effort with that of three years ago is revealing. Three years ago, for example, there was less than a handful of accounting fraud investigations and prosecutions involving Department of Defense contractors. There was little priority associated with accounting fraud cases. Investigative agencies and U.S. Attorneys were reluctant to commit resources to these matters.

As a direct result of the Unit's emphasis on accounting fraud cases, they are now an area of high priority in federal law enforcement. The Unit and Fraud Section attorneys have successfully prosecuted three such cases in the past 18 months. These include: (1) United States v. Systems Architect, Inc., which was a landmark conviction after trial of a complex mischarging case and the first such case in which high corporate officials were indicted and prosecuted; (2) United States v. Sperry Corp., a conviction of a major defense contractor for

labor mischarging; and (3) United States v. Automation Services, Inc., the first case in which a "second tier" subcontractor was criminally convicted for labor mischarging.

Unit and Fraud Section attorneys are actively investigating a number of major defense contractors for allegations of cost mischarging or other accounting frauds.

I noted before that U.S. Attorneys had been reluctant to devote resources to prosecute these cases. As a result of the Unit's leadership, U.S. Attorneys throughout the country now view procurement fraud cases as a priority area for prosecution. For example, the Philadelphia U.S. Attorney's Office convicted General Electric on May 13, 1985 of 106 counts of false claims and false statements. The same office also indicted four G.E. managers in the same investigation. One was found guilty at trial and one pleaded guilty; two are awaiting trial. Leadership impact can also be seen in the development of defense procurement specialists in U.S. Attorneys' Offices throughout the country.

Some examples of other types of defense procurement fraud prosecuted by the Unit and Fraud Section attorneys are: (1) the recent conviction of GTE Government Systems Corporation (GTE-GSC) and the pending prosecution of a GTE-GSC vice president, a marketing manager and a consultant for illegally converting classified DOD budgetary and planning documents; (2) the conviction of Davey Compressor Company and its former vice president for falsely inflating spare part invoices; (3) the prosecution of the overseas commissary cases; (4) the prosecution of One Stop Motor Parts, Inc., its president and two officials in a nationwide scheme for falsely inflating spare part invoices; (5) the continuing investigation of widespread bribery, kickbacks and corruption at the Defense Industrial Supply Center in Philadelphia, which has resulted in 20 convictions to date

involving more than $220,000 in bribes and kickbacks in contracts totalling $4.7 million; and (6) the recent conviction of Harold R. Heeszel, Jr., a government contracting official, for accepting gratuities in excess of $11,500 in connection with Navy contracts in Japan. These cases are more fully described in the information sheet I have provided entitled "Defense Procurement Fraud Unit."

During the past three years, the efforts of the Unit and Fraud Section have resulted in 34 indictments and criminal informations filed against 36 individuals and 10 corporations. A total of 31 individuals were convicted; four have not yet been tried. Judges gave only seven prison sentences. Seventeen did not receive sentences. Seven have yet to be sentenced. All ten corporations were either convicted at trial or pleaded guilty. Unit and Fraud Section attorneys are actively involved in directing approximately 25 investigations of procurement fraud. In addition, the Unit has under review 80 matters that are at the preliminary screening stage. These numbers do not include any cases prosecuted, investigated or screened by United States Attorneys Offices. 3/

The Department of Defense Inspector General has advised Congress that 45 of the top 100 Department of Defense contractors are under criminal investigation. Unit and Fraud Section attorneys are actively involved in directing the investigation and prosecution of 12 cases involving 9 of these contractors. The Unit also has under review an additional 23 investigative matters involving 14 of these contractors.

The Unit's numbers regarding the top 100 contractors do not include any cases under the active direction or review of the

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3/ The United States Attorneys Offices screen cases which do not meet the Unit's criteria, e.g. cases in which the estimated losses do not exceed $100,000; or which were brought to those offices before the Unit's centralized screening function was placed in operation.

Assistant United States Attorneys, nor any investigations in their initial stages that have had little or no contact with a prosecutor.

The nature of these types of investigations is that often the underlying conduct will not prove to be criminal in nature, but the result of accident, mistake, negligence or differing interpretations of contract provisions and accounting standards. These investigations often take substantial period of time before that determination can be made.

The Unit and Fraud Section caseload is growing at a steady rate. However, it would be a serious error to measure the Defense Procurement Unit's impact by the volume of its own caseload. The Unit has been a leader in developing procurement fraud enforcement policy and in establishing prosecutive priorities. It has been instrumental in training investigators and Assistant United States Attorneys. The Unit has assisted materially in establishing lines of communication between U.S. Attorneys Offices and components of the Defense Department. It has provided technical advice to prosecutors throughout the country and thereby had an impact on the quality and quantity of cases brought by U.S. Attorneys Offices. Its record of accomplishment is impressive.

I would like to return to the question of statistics for a moment to address an issue that may be of concern to you. Recently, misleading reports circulated to the effect that more than 400 procurement fraud cases had been referred by the Defense Department to the Unit for prosecutive action. That is simply incorrect. The number "400" included cases already prosecuted, cases awaiting prosecutive action, matters that have been brought to prosecutors for preliminary screening only and matters brought to the Unit's attention for informational purposes only. In fact, a majority of the 400 matters brought to the Unit's attention were for informational purposes only.

This incident, however, led us to examine, along with our colleagues at the Defense Department, the manner in which we account for our respective caseloads and how we use the key term "referral." We discovered that DOD and DOJ had been using the term "referral" to describe completely different events in the case development process. The term "referral" was understood by some to describe all matters brought to the Unit's attention for mere informational purposes. It was used by DOD to describe each matter investigators brought to the Unit for screening where little or no investigative work had been done. DOJ had been traditionally defining "referral" as a case which had been substantially investigated or which had been brought before a grand jury. This created confusion about the number of matters in the advanced stage of investigation or awaiting prosecutive action.

We have met with the Department of Defense and agreed on a common definition of "referral." That term is now defined for statistical and tracking purposes to mean "referral for screening." The Department of Justice Fraud and Corruption Tracking (FACT) System requires the completion of a FACT form for each investigation of government fraud, official corruption or theft of government property that is "referred" to the FBI or to a Department of Justice attorney for a preliminary prosecutive opinion.

A "referral" to the Unit occurs when the Unit screens a matter and renders one of the following prosecutive opinions: (1) the Unit accepts the matter for criminal prosecution (that is, grand jury investigation or other further investigation under the direction of a prosecutor) or for civil action; (2) the Unit refers the matter to an appropriate U.S. Attorney's Office; (3) the Unit returns the matter for more investigation; or (4) the Unit declines prosecution. Information merely forwarded to the Unit without a specific request for a prosecutive decision will not constitute a referral.

The above definition of "referral" for statistical and tracking purposes includes many situations in which little or no investigative work will have been accomplished at the time the Unit renders a preliminary prosecutive opinion. Therefore, the number of "referrals" for screening does not result in a statistic that reflects the number of cases at or near prosecution. We are hopeful that this refinement in how we keep statistics will eliminate unfortunate misunderstandings such as those which occurred recently.

The Attorney General recently announced an eight bill Anti-Fraud Enforcement Initiative to strengthen our ability to attack fraud against the government. The eight bills which make up this anti-fraud legislative package would give the Department of Justice important and, in some cases, long overdue weapons with which to deter fraud and bribery in connection with federal programs including Department of Defense programs.

These bills would: (1) make several changes in the False Claims Act to clarify ambiguities which have developed in case law and otherwise improve the government's ability to investigate and prosecute fraud cases and collect judgments; (2) establish an administrative mechanism for civil prosecution of claims under $100,000; (3) provide that suits brought to challenge the award of a government contract be heard exclusively in the Claims Court, a forum with great experience in dealing with government contracts; (4) permit the government to void contracts and grants tainted by bribery and allow the government to recover up to ten times the amount of any bribe; (5) aid investigative efforts by permitting Department of Justice attorneys investigating civil False Claims Act cases to gain access to material presented to a grand jury in related criminal prosecutions; (6) clarify DOD auditors' right of access and provide them with the necessary tools to subpoena the books and records of a contractor; make non-reimbursable legal fees of a DOD contractor; and empower the

Court to assess the costs of investigation and prosecution upon conviction; (7) replace current provisions relating to computer offenses with a more appropriate and effective set of computer crime laws; and (8) permit the Attorney General to retain private counsel to aid in the collection of debts owed the United States.

Let me point out that there are limits to what the criminal justice system can do. Criminal prosecutions provide one important weapons for ensuring integrity in the procurement process. But a criminal prosecution can be used only where fraudulent intent or corruption can be proved beyond a reasonable doubt. In the vast majority of cases of procurement waste or abuse - fraud either is not present or cannot be proven. Many of the problems involving defense contractors do not involve issues of fraud -- for example, purchasing equipment not needed or used, or purchasing equipment in uneconomical quantities, resulting in outrageous prices.

In these instances, integrity in the procurement system can be achieved through other tools: effective contract procedures, internal controls, and vigorous use of the suspension and debarment process.

But it is also important that the public understands that there will be situations where constitutional rights will interfere with prosecutions that include all guilty persons. For example, when an auditor finds that something is wrong with the books of a corporation and the only information we have is that which is on paper, i.e. there's two sets of books, we can't haul that bookkeeper into the grand jury and force him or her to tell us why there are two sets of figures. The Fifth Amendment protects each of us against self-incrimination. So it usually turns out that the bookkeeper's attorney comes in and says, "You give immunity and the bookkeeper will talk." That is how white

collar, i.e. paper trail, cases are worked. These are not bank robberies or crimes of violence where the very fact of committing the criminal act usually assumes the requisite intent or knowledge for prosecution. We have made a choice in this society of freedom and protection from excessive governmental intrusion that it is better to have the Bill of Rights than to get all those guilty of committing crimes. I am not ready to change that; I am sure this Committee is also not. Therefore, we commit ourselves to pursue vigorously these offenders, and also that we will do so without violating the Constitution.

JUSTICE DEPARTMENT RESPONSES TO QUESTIONS
SUBMITTED BY SENATOR SPECTER AT THE
OCTOBER 1, 1985 DEFENSE PROCUREMENT FRAUD HEARING

1. The stated goal of the Defense Procurement Fraud Unit is to combat fraud in the defense procurement process by prosecuting cases which are complex and nationally significant. What resources of the Department of Justice have been devoted to achieving that goal?

Response:

The Department of Justice is committed to providing all necessary resources to prosecute effectively cases of defense procurement fraud. As you know, in August 1982, the Attorney General and the Secretary of Defense established the Defense Procurement Fraud Unit to concentrate and coordinate national efforts to fight defense procurement fraud. The Unit was set up as an integral part of the Fraud Section, Criminal Division. Its current staffing is the result of gradual growth in the Unit since its inception.

The Unit has a current staff total of thirteen full-time and two part-time attorneys; this number includes seven Fraud Section prosecutors, one Assistant United States Attorney from the Eastern District of Virginia, two Department of Justice Civil Division attorneys (part-time), and five attorneys on detail from the Army (1), Navy (1), Air Force (1), and Defense Logistics Agency (2). Additional staff consists of five investigators on detail from the Defense Criminal Investigative Service (1), Air Force Office of Special Investigations (1), Naval Investigative Service (1), Army Criminal Investigative Command (1), and FBI (1); an auditor from the Defense Contract Audit Agency; a Criminal Division paralegal; a Criminal Division secretary and a Defense Department secretary.

In addition to the Department of Justice attorneys assigned to the Unit, attorneys from both the Fraud Section and the Civil Division can be assigned to particular Unit cases requiring additional resources. The Fraud Section has 36 attorneys in addition to those assigned to the Unit. Of those 36, eight are currently spending a portion of their time on matters involving major defense contractors.

The Justice Department's 94 United States Attorneys' Offices throughout the country have also committed resources to working defense procurement fraud cases. Several United States Attorneys' Offices, such as those in the Northern District of Texas and the Southern District of Ohio, have designated prosecutors to specialize in defense procurement fraud cases. In addition, 23 United States Attorneys' Offices in areas of major defense contracting have recently designated Assistant United States Attorneys to serve as defense procurement fraud representatives to assis' in the exchange of contract fraud expertise and the development of cases throughout the country.

2. What is the process for initially screening cases to determine whether or not they meet the standards of "complex" or "nationally significant"? How do these cases differ from those which would ordinarily be routed through the U.S. Attorneys' Offices?

Response:

The Defense Procurement Fraud Unit provides centralized preliminary screening of potentially significant defense procurement fraud cases. These significant cases are: (1) all audit reports involving suspected cost mischarging and other accounting fraud matters generated by the Defense Contract Audit Agency (DCAA); (2) significant investigative matters not originating from DCAA such as defective products and false testing certification; (3) all other DOD contract fraud matters with an estimated loss in excess of $100,000; and (4) bribery and

corruption matters regarding widespread corruption at a specific facility or matters involving senior government contract officials.

The United States Attorneys' Offices review cases that do not meet the Unit's criteria, e.g., cases where the estimated losses do not exceed $100,000. There are also cases in the United States Attorneys' Offices that were brought to them before the Unit's centralized screening function was placed in operation.

The preliminary screening by the Defense Procurement Fraud Unit is basically a preliminary evaluation for potential criminality so the Departments of Justice and Defense can focus on matters with prosecutive potential. The Unit screens matters at a very early stage, far in advance of the point prosecutors usually become involved. This process enables the Unit to utilize investigative resources more effectively.

If a screened matter contains sufficient information when received, Unit prosecutors can determine whether to accept it for criminal prosecution or civil action, refer it to the appropriate U.S. Attorney's Office or decline prosecution.

If a matter does not contain sufficient information to make an initial decision, the Unit will direct the investigating agency to conduct further investigation to obtain this information. Since the Unit is staffed with experienced prosecutors, investigators and DOD contract lawyers, they are able to suggest initial investigative steps to focus on matters of criminal potential and separate out matters that are civil, contractual or accounting disputes. The staff is also able to coordinate audit and investigative resources to insure the effective development of complex procurement cases.

The Unit provides leadership for all U.S. Attorneys in designating priority areas of investigation and prosecution. The areas it considers particularly significant are cases involving defective products, labor mischarging, defective pricing, and corruption. As you know, most defense procurement fraud cases are worked by United States Attorneys' Offices. The majority of the cases the Unit works are also prosecuted in conjunction with a U.S. Attorney's Office. Because the Unit staff has experience in investigating and prosecuting these cases, they are able to assist U.S. Attorneys by providing prosecutive and technical expertise as well as by insuring effective coordination of investigative and audit support. The decision to work a case within the Unit or forward it to a U.S. Attorney's Office depends less on the nature of the matter than on the resources and technical expertise of a U.S. Attorney's Office since the level of experience in handling these types of cases varies widely.

3. How many investigations have been conducted since the establishment of the Unit three years ago? How many of these investigations have resulted in prosecutions and/or convictions?

Response:

The Unit does not retain files on all matters brought to it for screening and prosecutive evaluation. The investigative files of the Defense investigative organizations and the FBI may contain such information.

We do retain conviction statistics. Attached is a list of all Defense Procurement Fraud Unit and Fraud Section defense contract fraud prosecutions from 1983-1985. The list is an updated version of the list prepared for Deputy Assistant Attorney General Victoria Toensing's testimony before the October 1, 1985 Defense Procurement Fraud Hearing of the Subcommittee on Administrative Practice and Procedure, Senate Committee on the Judiciary. As you know, most defense

procurement fraud cases are handled by United States Attorneys' Offices. The attached list of prosecutions does not include any of numerous convictions by United States Attorneys' Offices, such as the conviction of General Electric Company, the conviction of National Semi-Conductor Corporation, and the conviction of Rockwell International Corporation.

4. What would be the Justice Department's position toward restricting the ability of a trial judge to grant individual corporate officers freedom from prosecution in return for a corporate guilty plea? In how many instances does this situation arise, and how would you intend to deal with it?

Response:

The law provides that corporations are liable for the fraudulent actions of their corporate officials and certain employees. The decision to prosecute individuals and/or corporations depends on the law and evidence in a particular case. It is the Department's policy to prosecute both corporations and individuals involved in fraud. We have been and will continue to be as tough on contractors as the law and evidence in a case will allow.

We know of no instances in which a judge has dismissed a case against an individual in exchange for a corporate guilty plea. If such a situation did arise, we would oppose any dismissal by the court.

Senator GRASSLEY. It has become increasingly obvious, both from today's testimony and from the record of performance, that major changes are in order in the battle against defense fraud.

There is a mismatch between rhetoric and record, a serious breach of trust for the public. Both the Department of Defense and Justice have a credibility gap to fill. They have chosen to satisfy their obsession with looking good, rather than deal forthrightly with a clear and growing danger.

In the case of the Department of Defense, there is a feeling of no guidance or leadership. Those responsible choose not to be. Some point fingers and others pass the buck.

Fraud Unit attorneys seem to be in the wrong place at the wrong time. They get involved in cases they have no business in, and they ignore nationally significant cases handed to them on a silver platter.

Those of us on the outside looking in cannot tell if it is a genuine tragedy or if it is a case of the Keystone Cops. If the desire and the activity could match the rhetoric, we would be in fine shape. But, at least for the present, that is wishful thinking.

The concept of the Fraud Unit is, of course, very commendable and workable. Yet it is our window of vulnerability. If we use it effectively, we deter fraud; if we fail, we are wide open and vulnerable.

Unfortunately, our Fraud Unit is inflicted with a disease called bureaucracy. It can only deal with what is familiar to them.

Peter Drucker, the management specialist, says the following about bureaucracies: They are not paid for what taxpayers and customers mean by results in performance; being paid out of budget allocations changes what is meant by performance or results. Results in budget-based institutions, or bureaucracy, means larger budgets. Results, as the term is commonly understood, are, in effect, secondary. What people mean by a bureaucracy and rightly condemn is a management that has come to misconceive itself as an end and the institution as a means.

These insights from Drucker helps us understand, but, by no means excuse, the failures of the Fraud Unit. Historically, this is our first attempt to combat rampant fraud. It has never before been achieved; to do so, though, we need innovative techniques and aggressive prosecution.

Somehow, the Fraud Unit has to be shocked into the real world. It can no longer afford to tolerate Justice attorneys playing the gods on Mount Olympus, and the bureaucrats bickering and finger pointing.

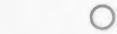
We have a very serious problem, and all we keep hearing is that black is white, and that the Fraud Unit's record is impressive and that the problem is under control, and then they go back to their turf wars and internal politics, while tax dollars remain easy prey for Defense contractors.

It is not easy to know what to do from here. On the one hand, the concept of the Fraud Unit is a valid one; on the other hand, what do you do with a department that denies the obvious?

What is clear at this point is that the Departments of Defense and Justice have a responsibility to correct the record, as they have represented it, to admit that they are stricken with bureaucratic

inaction and to match the magnitude of the problem with the same magnitude of the effort.

[At 12:41 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]



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